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POSTAL SERVICE'S CONTRACT WITH PEROT SYSTEMS CORPORATION

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE, AND CIVIL SERVICE

AND THE

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

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POSTAL SERVICE'S CONTRACT WITH PEROT SYSTEMS CORPORATION

WEDNESDAY, AUGUST 10, 1988

U.S. SENATE, SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE, AND CIVIL SERVICE, AND THE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, COMMITTEE ON GOVERNMENTAL AFFAIRS,

Washington, DC.

The Subcommittees met, pursuant to notice, at 10:10 a.m., in room SD-342, Dirksen Senate Office Building, Hon. David Pryor and Hon. Carl Levin, Chairmen of the Subcommittees, respectively, presiding.

Present: Senators Pryor, Levin, Stevens, and Sasser.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Good morning. The Subcommittees will be in order, and I might note that Senator Levin and I will jointly chair the hearing this morning. We have worked very closely together on this issue.

In late May, after several months of closely held negotiations, the Postal Service entered into a very unique, far-reaching and what has become a highly controversial sole-source contract with the newly formed Perot Systems Corporation. The final Postal Service offer, as it turns out, was made on May 26th, the very day that Postmaster General Frank last appeared before the Federal Services, Post Office, and Civil Service Subcommittee.

My initial reaction to the public announcement was somewhat positive. The Postmaster General had apparently come to grips with the gravity of the situation at the Postal Service. He had concluded that he was in need of some very special assistance, the kind that was not available at that time in-house.

However, as the details of the contract were made public, especially those pertaining to ownership of ideas, exclusive implementation rights, and shared savings, it became clear to me, and I might add to many of my colleagues, that it would be a mistake to allow this contract to go unnoticed, undiscussed, and unmonitored.

On June 22, the Senate adopted a Sense of the Senate amendment directing the General Accounting Office to report to the Congress within 45 days on the contract between the Postal Service and Perot Systems and directing the Postal Service to delay any Phase II or implementation activities for 45 days thereafter.

Today, the General Accounting Office will report its findings. It is my expectation that during the next month and a half, the

Postal Service will address many of the concerns raised by the GAO's study and others participating in this hearing. I do not, at this time, anticipate that a legislative solution will become necessary.

The Postal Service is a creature of the Federal system. It is referred to in the Constitution and as an independent establishment within the Executive Branch, it is very unique and different, but it is not necessarily sacred. I believe that the Congress has an obligation to the mailing public, and that is just about everyone, to carry out effective oversight, and that is exactly what I hope this hearing will be about and address today. Senator Levin.

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Thank you, Senator Pryor.

On May 27, 1988, the Postal Service entered a sole source contract with Perot Systems Corporation. Under Phase I of this contract, Perot Systems is required to conduct a 90-day study of transportation, telecommunications, delivery services, revenue protection, and mail transportation equipment used by the Postal Service.

Under Phase II of the contract, Perot Systems was given the exclusive right to implement any of its recommendations that are accepted by the Postal Service for a period of five years and a share of the resulting savings for at least 10 and up to 20 years. To say the least, this is a truly unique and extraordinary contract. To put it more bluntly, it has all the elements of a sweetheart deal.

Negotiation of the contract appears to have started with the decision by the Postmaster General, that a very substantial and important contract would be awarded to Perot Systems. The Postal Service then seems to have worked backwards to justify the contract and determine what the terms would be.

At the time the negotiations began, Perot Systems did not even exist. At the time the contract was signed, it was still a paper company with no track record and no employees. Nonetheless, the Postal Service approved the sole source award to Perot Systems based on "the unique capabilities and arrangements of R. Perot for this effort." All of this was done without any consideration of even the possibility that another contractor might be interested or able to do the job.

These procedures appear to have violated the requirements, not only of the Competition in Contracting Act, the applicability of which the Postal Service disputes, but also the terms of the new Postal Service Procurement Manual. The Postal Service failed to consider the appropriate circumstances for sole source awards listed in the Procurement Manual, failed to make a determination of price reasonableness, failed to conduct any meaningful cost analysis, failed to develop a procurement plan, failed to request cost or pricing data, and failed to develop a statement of the work to be performed.

The Competition in Contracting Act, which I sponsored with Senator Cohen four years ago, creates a clear preference for the use of competition in Federal contracts. In passing the Competition in Contracting Act, the Senate recognized that competition can result

in significant cost savings, a stronger and broader industrial base, and fair play in the expenditure of public funds.

Regardless of whether the Competition in Contracting Act applies directly to the Postal Service, these basic principles of economy, efficiency and equity must apply. There is a strong appearance that they were ignored by the Postal Service when it entered this contract.

Moreover, the contract itself contains a number of extraordinary provisions, which afford maximum control to Perot Systems and minimum protection to the Postal Service. The contract, which calls for Perot Systems to make recommendations to the Postal Service on an extremely broad range of management decisions, has the following features.

It waives normal conflict of interest rules to permit Perot Systems to implement its own recommendations. It gives Perot Systems the exclusive right to implement these recommendations for a period of five years and exempts it from competition in this work. It provides for Perot Systems to share in any savings, but not in any losses resulting from these recommendations, while the Postal Service bears the full cost of implementation.

It puts Perot Systems in a position to establish the methodology for calculating current and future costs, thereby giving it significant ability to define its own profits. It gives Perot Systems extraordinary leverage in determining its profits by deferring negotiations until Phase II, at which point Perot Systems has the exclusive right to implement any of its proposals.

It surrenders, for a period of two years, the right of the Postal Service to terminate the contract for the convenience and the interest of the Government, with the exception of that 90-day sidebar letter, which was signed near the end of the negotiations. And it requires the Postal Service to continue to pay profits to Perot Systems if the contract is terminated for the convenience of the Government after the two-year period.

Taken together, these provisions appear to offer minimal protection to the Postal Service and to afford an opportunity for abuse by a private party. As the General Services Board of Contract Appeals found in an opinion released last Friday, the Postal Service simply did not comply with the spirit and letter of its own regulations in deciding to proceed on a noncompetitive basis in awarding this contract to Perot Systems.

Moreover, the Board found that the Postal Service was "fully aware of the favoritism shown Perot Systems and of the palpable illegality of the awarded contract." When we in the Senate learned of this contract a month ago, many were greatly troubled by its provisions. For this reason, the Senate unanimously passed a resolution requiring the General Accounting Office to review the contract and calling upon the Postal Service to refrain from implementing Phase II until 45 days after the GAO delivered its report.

Subsequently, as I noted, the General Services Board of Contract Appeals held the contract to be illegal, although the Postal Service disputes the Board's jurisdiction to render this decision. The GAO has now completed its review of the Perot Systems contract and we look forward to their testimony today. We also look forward to the

testimony of the Postmaster General and, of course, we look forward to the testimony of our colleagues.

In addition to Senator Simon, we have Senator Grassley on the panel, but I want to focus on Senator Simon, if I can, for the leadership that he took in bringing this to the attention of the Senate a few weeks ago.

Senator PRYOR. Senator Stevens.

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. Mr. Chairman, I hope I can be here for all of this hearing, but as I am sure you all know, the Defense Appropriations bill is on the floor and I must leave to help manage that bill when it becomes necessary.

I am still very concerned that the Senate wants to micro-manage the Postal Service. I think I am the only one left on the Committee that was here at the time we reorganized the old Post Office Department. Clearly, we did not intend that the Congress, as a whole or either body, should get into the micro-management of activities of the Postal Service.

They have the power to make these contracts and unless they are in violation of law, which is not a matter for the Congress to rule on, but for the Attorney General or the GSA Board, then I believe that they should be allowed to proceed, and particularly, in terms of Phase I. I hope that the Postmaster General will explain that further today to the Members here.

Phase I of this contract, in my judgment, could not be against the public interest, limited as it is, and I am one who hopes the Postmaster General will proceed with Phase I, notwithstanding this hearing or any interference by any member of the Congress. It is not our prerogative, under existing law, to interfere with the contracts of the Postal Service.

Now, I do not know how I can be any plainer than that, Mr. Chairman. I have great respect for you and the job you do in carrying out the responsibilities the Congress does have, but in my judgment, this is not one of them.

Senator PRYOR. Thank you, Senator Stevens.

The June 22 date was already mentioned, I believe, twice in opening testimony, and that was the date that a Sense of the Senate amendment was adopted on the Senate floor, directing the General Accounting Office to report to the Congress within 45 days on this particular contract. The two authors of that amendment, Senator Simon and Senator Grassley, are here. Senator Simon, we will call on you at this time.

TESTIMONY OF HON. PAUL SIMON, U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator SIMON. Thank you very much, Mr. Chairman. My apologies for just speaking and running. I have a mark-up in another committee where I have some legislation pending.

Senator PRYOR. Paul, if you would just pull that microphone a little closer.

Senator SIMON. All right. I will do so.

Senator PRYOR. Thank you very much.

Senator SIMON. I want you to hear every important word.

Senator PRYOR. Every word. [Laughter.]

Senator SIMON. All right.

Let me, by way of background, say, when I was elected to the House, I requested to be on the Education and Labor Committee, which I was appointed to and then I was appointed to the Post Office Committee, which I did not request to be appointed to. For two years, I found out a lot more about the Post Office than I ever intended to find out and I have been interested in what is taking place.

We have here, as Senator Pryor and Senator Levin have indicated, a very unusual contract. In all my years in Government, I have never seen one like this. While I do not, to quote Senator Stevens, want to micro-manage the Postal Service, I also want to protect the people who are paying those postage rates and the Postal Service is a very important function to this country. I have no objection to Phase I. I do not think any of us have objection to Phase I.

I think the question is on Phase II and there, I would like to insert into the record, a letter that was circulated by Congressman Jack Brooks and Congressman Frank Horton, if I may.[1]

Senator PRYOR. Without objection.

Senator SIMON. While the GSA has ruled that the contract is invalid, it may be that the Postal Service is correct that they do not have jurisdiction. I, frankly, do not know. But the question for this Committee is not the question of jurisdiction, it seems to me. It is a question of whether that contract is sound.

Just in glancing through the presentations that you are going to hear, the GAO, I note, says the contract is loosely written in key particulars and does not adequately protect the interests of the Postal Service, its ratepayers, and the Government. I think that that is a pretty good summation of Phase II.

I think we have to protect the public. I would like to make clear, this is not an anti-Ross Perot thing on my part or on the part of anyone. He is a citizen who has contributed immensely, particularly in the State of Texas on the education area. I just have tremendous respect for what he has done. And I am not opposed to him bidding on Phase II, but that is precisely what he and his organization ought to do. They ought to bid, just like any other company. And it ought to be much more tightly written.

That contract says they will get a percentage of the savings; it does not say what the percentage is. Mr. Perot called me the day after we had the amendment adopted on the floor of the Senate. He said, well, I had an informal understanding with the Postmaster General, it was going to be 10 percent of what we would collect.

Those informal understandings are not part of the contract. We ought to know about those things. I just met the new Postmaster General for the first time. I hear good things about him. I just have glanced through his testimony. He talks about bidding on Phase II, though the consulting function that the Perot Systems would have, I think, you will have some questions about and I think ought to be gone into carefully. I would add, there is no one in the Senate or

[1] See p. 89.

the House that knows more about consulting than Senator Pryor, and I applaud your leadership on this.

I think what you clearly ought to get out of this oversight hearing is an agreement from the Postmaster General that there will be, in no uncertain terms, competitive bidding on Phase II. If that agreement is not forthcoming, then legislative action may be necessary. But ideally, this oversight hearing should resolve the problem and protect the people of the Nation and that is what we are all interested in.

I would be happy to answer any questions. Otherwise, I am going to head on to my mark-up.

Senator PRYOR. Senator Simon, thank you.

Are there questions from Senator Levin or Senator Stevens?

Senator Simon, we very much appreciate your testimony.

Senator SIMON. Let me just add, Senator Stevens worked with me on the floor also in getting this amendment worked out, and I appreciate his working with me, as well as my colleague, Senator Grassley. Thank you.

Senator PRYOR. Thank you. Senator Grassley.

TESTIMONY OF HON. CHARLES E. GRASSLEY, U.S. SENATOR FROM THE STATE OF IOWA[2]

Senator GRASSLEY. Thank you, Mr. Chairman, for allowing me to participate in these considerations that you are conducting today. And while I am not a member of this Committee, I have had an opportunity to work with both you and Senator Levin in the past on a number of Government procurement issues. Many of those issues have involved the Defense Department in the past, where the absence of competition has been obvious to the public and very detrimental to the public interest.

We have sought to remedy the ills of Government procurement through the tried and true principle of competitive bidding. I do not think it is any different today. The issue before us today is just that, no different. When should competitive bidding be used and when not? We all know too well that Government procurement rules are not perfect. We also know that competition, in and of itself, will not guarantee that all Government contracting will not, in some way, be abused.

However, I think we ought to remember that no one has discovered a method that more adequately protects the taxpayers' interest than does full and open competition. We, as the legislative body, not in a micro-management sense, but in a broad decision and policymaking sense, have repeatedly affirmed this belief through laws we have passed. I think we are here for that same reason today.

The record clearly shows that competition does work. Whenever competition is possible, the best interests of the taxpayers demand that it is employed. It is a long-desired goal that the Postal Service provide this country with the most efficient and least-costly operation that it takes to move the mail. That was my hope when I first learned of the contract between the Postal Service and the

[2] See p. 31 for Senator Grassley's prepared statement.

Perot Systems, Inc., and, of course, before I became familiar with the contract.

Upon scrutiny of the contract and the details surrounding its award, a totally different picture does emerge. This contract suddenly loomed as a potential wolf in sheep's clothing—the absence of competition, the sole source method without justification, the institutional conflict of interest, the unspecified savings/profits arrangements, and other areas of the contract. These all contributed to an undeniable violation of what we in Congress have fought hard over the years to prevent.

As I understand it, Mr. Chairman, the Postal Service's new procurement regulations allow noncompetitive purchases, only under certain limited circumstances. These include, for instance, when there is an unusual and compelling urgency or when competition is not in the U.S. Postal Service's interest.

In his written testimony, Mr. Frank does not specify which of these circumstances were present as a justification for awarding a sole source contract. The General Accounting Office report states that an inadequate justification was given and that a provision to waive the justification was not exercised.

What is offered by Mr. Frank, however, is the statement that the Perot Systems would provide a new and fresh approach to solving the Postal Service's problems. Now, the question is—and it seems to me, Mr. Chairman—whether that is justification enough to sidestep the Postal Service's new and fresh procurement regulations and to sidestep the obvious benefit to the taxpayers from the rigors of competition.

It is apparent that numerous contractors could have met the contract's requirements or, at a minimum, should have been given a fair shot. As you know, Mr. Chairman, several companies challenged the Postal Service's award to Perot Systems in statements before the General Services Board of Contract Appeals. Both Perot Systems and the Postal Service failed to turn over numerous internal documents during the Board's discovery procedures.

At my request, the General Accounting Office recently obtained at least some of these documents, which were provided to me late yesterday. The documents paint a disturbing picture of the process by which this contract was awarded. The Postal Service documents show that within a week of assuming his job as Postmaster General, Mr. Frank advised his subordinate that he anticipated "making available for the company of * * *," and that is referenced in this document.

Let me read from the document so it is more clear because it does not use Mr. Perot's name. "In anticipation of making money available for the company of last night's guest * * *" I think it is clear from the reports in the media that the guest was Mr. Perot.

At the time of this statement, the Postal Service had not even determined when, and if any, work could be performed by Mr. Perot's company. Mr. Frank's seemingly premature decision, prior to any contract negotiations, might suggest favoritism toward Mr. Perot. It also opens the Postal Service to the obvious charge, whether correct or not, that at least part of the motivation behind this contract was not to save money for the Postal Service and the taxpayers, but to make money for Mr. Perot.

From another document, I think we can assume that the Postal Service also apparently sought out creative methods for transferring money to Mr. Perot. When asked to devise ways of funding a contract for Ross Perot, the controller of the Postal Service advised that money was no problem and that if necessary, the Postal Service could revise its deficit estimates to come up with whatever cash was needed.

Here is a direct quote from one document: "[Mr. Porras] advised that the Department of the Controller could develop sources for whatever funding is required. In the simplest case, the revised estimates of the deficit for the year could be adjusted to cover the necessary amount, but other options are available depending upon the dollar amount needed."

Again, Mr. Chairman, this is disturbing in the sense of potential public outrage. During this same period when the Postal Service pleaded poverty as justification for massive postage rate increases, it was also willing to cook the books to come up with money for Mr. Perot, if these documents are correct.

As I mentioned earlier in my testimony, Mr. Chairman, we should be wary of any wolves in sheep's clothing. This contract should be examined for both the appearance and the reality of favoritism, as well as unsupported restrictions on normal competitive procurement. The decision to enter into this contract appears to have been made before the Postal Service decided what the contractor was supposed to do and the contract terms provide no protection against procurement abuses that we have seen in the past, associated with sole source contracts.

So, in conclusion, it is my view, Mr. Chairman, given the facts already in the public domain, the fairest of all possible options would be to wipe the slate clean, subject the contract to competition, and this time, try to ensure the best possible deal for the taxpayers of this country. Knowing of your outstanding record, Mr. Chairman, on procurement reform, I have every confidence that this Committee will do whatever it can to assure a just resolution of this matter.

I thank you again for inviting me to participate in this hearing. I look forward to working with you on the solution to these problems, much the same way we have done on Defense procurement reform.

Senator PRYOR. Senator Grassley, thank you for your very fine statement. Senator Levin, any questions?

Senator LEVIN. Just a request. We are grateful for your work in this area. You have been an intrepid fighter against waste in the procurement field and we all have benefitted from that.

There are some documents that you have made reference to which we may not have. The request would be that you file those for the record, if you would.

Senator GRASSLEY. I have copies of them right here. I will just leave them on the table for you.

Senator PRYOR. Thank you, Senator.

Senator GRASSLEY. Two documents. Both of which I have referred to already.[3]

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[3] See pp. 90, 91.

Senator PRYOR. Senator Stevens.

Senator STEVENS. I have no questions. I again reiterate that, in my judgment, those who wish to micro-manage the Postal Service are going to push it towards privatization and I regret sincerely that we are getting to the point where we are getting into personalities and accusations to the extent that we are. I have no questions for the Senator.

Senator PRYOR. Senator Sasser.

Senator SASSER. No questions, Mr. Chairman. I want to join Senator Levin in commending Senator Grassley on his leadership in the whole field of consultants. He has done excellent work on that for a period of four or five years and, to some extent, has been a voice in the wilderness until just recently. I want to join with Senator Levin in telling our colleague, Senator Grassley, that we are going to listen to him with great interest and more care in the future.

Senator GRASSLEY. Thank you very much. I suppose I ought to be smart and just leave after that. But I cannot help but make one final comment. It is my judgment that setting up a policy of competitive bidding and policing that system is just the antithesis of micro-management. If we were going to micro-manage, we would issue the contracts and decide on them.

Senator PRYOR. Senator Grassley, thank you for your statement.

We will call now Mr. Milton Socolar, the Special Assistant to the Comptroller General, General Accounting Office. I believe Mr. L. Nye Stevens, the Senior Associate Director of the General Government Division is accompanying you. We look forward to your statement.

TESTIMONY OF MILTON J. SOCOLAR, SPECIAL ASSISTANT TO THE COMPTROLLER GENERAL, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY L. NYE STEVENS, SENIOR ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION

Mr. SOCOLAR. Thank you, Chairman Pryor and Chairman Levin. I have submitted a statement which I would appreciate being inserted into the record.[4]

Senator PRYOR. Without objection.

Mr. SOCOLAR. And in the interest of time, I thought that I might summarize that statement and respond to any questions that you or the other members of the Committee may have.

The contract that we are talking about today is a most unusual contract. It did not arise through application of the regular procurement Postal Service contracting procedures. The contract was essentially predicated upon the Postmaster General's personal confidence in the personality and character of Mr. H. Ross Perot and confidence in Mr. Perot's ability to put together a first-class team to examine postal operations and to devise and implement projects or improvements in those operations.

While the Postal Service sought to document compliance with its Procurement Manual requirements, it is clear that such efforts were after-the-fact actions, rather than having been based upon

[4] See p. 36.

pre-selection considerations leading to Perot Systems as the only source capable of fulfilling the Postal Service's needs. In essence, the deal was set without great concern over manual instructions designed to assure sound procurement practices. This was a one-of-a-kind contract.

In the most generalized terms, the contract calls for Perot Systems to study postal operations for three months and to then submit statements of work for projects to be implemented in five operational areas. The three-month study was to be on a cost reimbursement basis, limited to a total of $500,000 with no fee. Perot project proposals approved by the Postal Service were to be separately negotiated, with Perot Systems sharing in savings realized by the Postal Service at percentages to be separately determined.

We have four principal concerns with the main outlines of the contract. First, the contract assumes that submitted projects will be approved unless there is appropriate reason not to approve. The Postal Service, for a period of five years, is not to implement any project independently of Perot Systems.

The contract is silent with regard to projects which the Postal Service delays or does not approve or which are essentially based upon work previously done by others. We think that the contract vests too much control in Perot Systems over its work products and would point out that the Service is subject to claims by Perot Systems for projects not approved, but which the Postal Service subsequently, independently implements.

Second, we are concerned that the contract contains no limit on the amount of savings Perot Systems might earn. In light of the expectation that its proposed projects will be approved, together with the Postal Service being prohibited from implementing projects independently of Perot Systems, we think the contractor is placed in too strong a bargaining position when savings ratios are negotiated.

Third, we are concerned that the contract does not provide a general clause allowing termination by the Postal Service without liability for breach should the continuation of the contract, at some point, not be in the best interest of the Government. Termination by the Postal Service during the initial 90-day study period is allowed under a separate agreement with Mr. Perot.

Termination for convenience of the Government is then precluded for two years after the initial date of award with Perot Systems entitled, should the contract then be terminated, to 50 percent of the negotiated share of savings that would have been paid had the contract not been terminated prior to the end of its intended ten-year life.

Finally, we are concerned that the Postal Service's sole source justification is unconvincing. The written justification fails to establish that Mr. Perot is the only one who can do the required work and while it emphasizes his personal qualities, the contract does not require any commitment of Mr. Perot's time.

You have asked whether existing Postal Service laws and regulations are adequate to ensure effective competition and protect the interests of the Government and the public. You have also asked whether the Brooks Act, governing ADP procurement, and other contracting laws and regulations generally applicable to Govern-

ment procurement, should be made applicable to the Postal Service.

The Postal Service Reorganization Act of 1970 specifically exempted the Postal Service from all Federal laws dealing with public or Federal contracts. The underlying purpose of the Reorganization Act was to allow the Postal Service to function more like a private business.

Appreciating that the Postal Service recognizes the need to maintain strong procedures and internal controls and that it recognizes the need to provide systematic training to raise the level of procurement personnel performance, I would hesitate to suggest, particularly on the basis of this one contract—which, as I stated earlier, did not emanate from the procurement system as such—that the various generally applicable contract laws and regulations be reapplied to the Postal Service.

That is not to say though, that I would agree that a contract such as the contract we are talking about today, should be awarded without consideration of the provisions that are currently in the Procurement Manual that do provide for competition in obtaining services and goods needed by the Postal Service.

I would have to state one exception though, and that exception concerns the Brooks Act, which governs the very specialized procurement of ADP goods and services throughout the Government, with limited specified exceptions. As you know and has been stated here today, the General Services Board of Contract Appeals recently ruled that the Perot Systems contract is void for failure to follow the Brooks Act. That decision is now on appeal to the Court of Appeals for the Federal Circuit.

Experience in the Executive Branch is that ADP systems are too often inadequately planned and implemented, winding up with huge cost implications for systems that do not do the job required, to a large extent, because agency procedures and practices do not follow Brooks Act requirements. If it takes applicability of the Act to assure Postal Service compliance of a good ADP procurement practice, the Act should be made to apply. As it stands now, the Act does apply under the terms of the GSBCA opinion and will continue to apply if the Court of Appeals affirms.

Apart from any question as to whether the contract comes under the Brooks Act in terms of the services being required, as opposed to the issue of whether the Postal Service itself is subject to the Brooks Act, I think that there is a strong likelihood that the Court of Appeals will affirm that aspect of the Board's opinion.

That completes my summary, Mr. Chairman, and I would be glad to answer questions.

Senator PRYOR. We appreciate your statement very much and also the study that you have provided the Subcommittees. We will invoke the five-minute rule. Each Senator will have five minutes and then we will rotate. We will also utilize the "early bird rule" this morning and that would mean that after I question, then Senator Levin, then Senator Stevens, and then Senator Sasser.

The first question is, was this a solicited contract or a solicited proposal from the Postal Service to Mr. Perot?

Mr. SOCOLAR. No, I do not think it was.

Senator PRYOR. It was an unsolicited contract? Mr. Perot's company walked into the Postal Service and said, we would like to do this study for you? Is that the case?

Mr. SOCOLAR. Rather than Mr. Perot walking in, I think that a more accurate description would be to say that the Postmaster General sought out Mr. Perot on the premise that he and Mr. Perot would be able to fashion a contract that would be satisfactory to both parties.

Senator PRYOR. In order to establish your credibility, Mr. Socolar, how many years have you been with the General Accounting Office?

Mr. SOCOLAR. I think it has been 36 years.

Senator PRYOR. All right, you are an expert.

Second, have you ever—I think you said this is a very unique contract—have you ever seen a contract anywhere near similar to this Perot contract?

Mr. SOCOLAR. No, I have not.

Senator PRYOR. Have you ever seen a contract awarded by the Government that gives the proprietary interest in ideas?

Mr. SOCOLAR. There are provisions of some contracts dealing with patent rights that do give a proprietary interest to the contractors who develop them. As a general proposition, though, the kind of interest that this contract provides in precluding the Postal Service from implementing any of them without compensation to the contractor is most unusual.

Senator PRYOR. All right. Let me set up, if I may, a very quick fact situation. Let's say that if Phase I of this contract is implemented and Mr. Perot is the contractee and he makes a recommendation in the next several weeks that the Postal Service, I am not sure about all this, let's assume the Postal Service is now using six-cylinder Chevrolet trucks or cars, it does not matter—let's say that Mr. Perot suggests that if you use four-cylinder Fords you will save a lot of money.

And, let's assume that the Postal Service says, "Mr. Perot, that is a great idea; a wonderful idea; we are going to go out and buy 3,000 new four-cylinder Fords." Does Mr. Perot get any piece of that action, or an override, or any part of that?

Mr. SOCOLAR. As I understand the contract and there is another aspect to it which is troublesome in regard to the question that you just asked and that is, that Mr. Perot would have a great deal of control over the methodology that would be provided for determining the baseline costs in order to measure the savings that the Postal Service would be benefitting from and, in that context, would, I think, under the plain terms of the contract, have a piece of the action, as you just suggested.

Senator PRYOR. Under that fact situation, if the Postal Service decided not to buy any four-cylinder Fords now, how long do they have to wait before they could actually go out and buy any Fords? Is that five years? Is that a proprietary idea or suggestion of Mr. Perot under the contract?

Mr. SOCOLAR. If we are correct that that provision would come within the ambit of the contract, they would have to wait five years and the contract provision, at that time, that is applicable, would simply allow Perot Systems to compete for whatever it is,

after that five-year period, that the Postal Service was entering into.

Senator PRYOR. We are having a roll call vote on the floor right now. In order for my colleagues to get one or two questions in before we break, I am going to yield back the balance of my time in this questioning and yield now to Senator Levin and then to Senators Stevens and Sasser. So, Carl, if you could ask a couple of questions and then let Ted and Jim ask a couple.

Senator LEVIN. Is your answer to that last question, if that contract comes within the ambit of the agreement or that that contract sounds like it comes within the ambit?

Mr. SOCOLAR. No. What I meant was that in terms of the implementation of any projects, that would be subject to further negotiation and under the terms of the contract as they exist, the hypothetical that was posed could very well be negotiated into a particular project.

Senator LEVIN. Just a few quick questions and then we will come back in our second round. Section Two of the Postal Service Procurement Manual requires the development of a procurement plan for every contract.

Did the Postal Service comply with that requirement in this contract?

Mr. SOCOLAR. It is clear to me that they did not.

Senator LEVIN. Section Four of the Procurement Manual requires a price analysis and recommends a cost analysis for every sole source contract.

Did the Postal Service comply with that requirement?

Mr. SOCOLAR. No, it did not.

Senator LEVIN. Section One of the Procurement Manual requires contracting officers to identify, minimize, and avoid potential organizational conflicts of interest.

Did the Postal Service comply with that requirement of their own manual?

Mr. SOCOLAR. That is a little bit complicated, I think.

Senator LEVIN. But that is not a clear yes or no?

Mr. SOCOLAR. I can go into it if you wish, but right now——

Senator LEVIN. Are you able to give us a clear yes or no on that?

Mr. SOCOLAR. No, I am not.

Senator LEVIN. Then I would rather proceed and come back to that later.

Mr. SOCOLAR. Sure.

Senator LEVIN. Section Four of the Procurement Manual requires a written justification and approval for any sole source contract and to specify—and to specify—in that justification the basis upon which the justification is made.

Did they comply with their own manual?

Mr. SOCOLAR. No, they did not.

Senator LEVIN. So at least in three of the four areas that I just asked you, they did not comply with their own rules?

Mr. SOCOLAR. That is correct.

Senator LEVIN. I think Senator Stevens is next in the order that was given.

Senator STEVENS. Mr. Socolar, you do not have another Government agency like the Postal Service, do you?

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Mr. SOCOLAR. There are other Government corporations that are exempted from contracting laws, yes, but none like the Postal Service.

Senator STEVENS. None that have been told to be as independent as you can, the eighth largest corporation in the United States operating under a Board of Governors with a group that sets their own rates and governs the operations of this Department as though it were private, but still subject to Government oversight. Do you have anyone else?

Mr. SOCOLAR. That is correct, unless one might compare say, the TVA, to that kind of operation in terms of its selling of power and setting power rates and so forth.

Senator STEVENS. You know, of course, that EDS did have a series of noncompetitive amendments that were none of them subject to the rules and regulations of the Brook Act and were issued noncompetitively in the last seven to eight years? You came across that, I assume.

Mr. STEVENS. Yes, sir, we did. You mean, from the Postal Service contract?

Senator STEVENS. Yes.

Mr. STEVENS. Yes, sir.

Senator STEVENS. In your review of this, did you discuss this matter with the General Motors people?

Mr. STEVENS. No, we had contact with Mr. Perot from EDS, that is formerly of EDS, but we have not had contact with the present management of EDS or of General Motors. No, sir.

Senator STEVENS. Now, the impact that I get of your presentation is that you disagree with the Postal Service's position before the Court of Appeals on the relationship between GSA to their operations, is that correct?

Mr. SOCOLAR. I think that it is a very close question, but on balance, I would fall on the side of agreeing with the GSBCA opinion.

Senator STEVENS. Well, this Senator would fall on the other side. It just shows to me that we need a third judge, all right?

But as a practical matter, in terms of looking at this agreement and accepting your statement that the Postmaster General, knowing that Perot is a very unique individual with a very unique staff, had, under the agreement with General Motors and EDS, agreed not to participate in profit-making activities for a period of time, was available and if he could be interested, could undertake a specific review for the Postal Service.

Did you see anything illegal in that activity?

Mr. SOCOLAR. To the extent that the contract contemplates ADP services or ADP goods and to the extent that the Brooks Act does apply, then there would be legal problems with the arrangement that was made.

Senator STEVENS. If you assume that the Postal Service loses its case with GSA, you would come to the conclusion that there was something wrong with the procedures, but if you assume that they are correct in their approach, that the GSA procedure did not apply, then your answer would be the other way, is that correct?

Mr. SOCOLAR. My answer on straight-forward legal grounds would be the other way, but I would not want to leave the impres-

sion that I think that it is appropriate to contract on the kind of personal basis that this contract was executed on.

Senator STEVENS. I cannot come back, so I will ask just one more question.

If you assumed you had the right to review AT&T contracts, then the private sector and the USPS was, in fact, a part of the private sector, do you know of your own knowledge that activities as they were described here by you in terms of seeking out a very unique team to do a unique job would be inconsistent with the practice of this country, the private sector?

Mr. SOCOLAR. No, I do not think so, but the difference, I think, would be that the Postal Service does have a Procurement Manual, which lays out for itself the basis on which Postal Service contracts will be entered into and it is, to a large extent, a failure to comply with its own manual that raises a great deal of questions.

Senator STEVENS. You take the position that the manual would be applicable to Phase I?

Mr. SOCOLAR. I think the manual is applicable to all Postal Service procurements.

Senator STEVENS. Thank you very much. We will have to stand at ease.

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Well, before we do, I ask unanimous consent and since there is no one here to object—Senator Stevens is going out the door—I want to have my opening statement included in the record.

[The statement of Senator Sasser follows:]

PREPARED STATEMENT OF SENATOR SASSER

I want to commend Senators Pryor and Levin for holding this hearing today.

We are here to examine the recent contract proposal between Mr. Ross Perot and the U.S. Postal Service.

This is a far-reaching contract. It is intended to be the basis for major cost savings for the Postal Service. In that regard, I commend Postmaster General Frank for making a major cost-cutting program one of his first efforts as Postmaster General.

However, as this hearing will detail, this proposed contract has a number of highly unusual features which have caused the Congress and the general public to question the propriety of this contract. The many questions regarding the Perot contract will be, I am sure, thoroughly reviewed by the Governmental Affairs Committee.

I will have a few questions myself for the Postmaster General concerning various features of the Perot contract.

In the final analysis, I do hope, however, the committee will work with the Postmaster General in assisting his efforts at developing a strong cost cutting program at the Postal Service through a system of competitive contracts that will bring the Postal Service the best advice possible on how to reduce costs while maintaining the highest possible level of Postal Service to the American people.

Senator SASSER. The hearing is recessed, subject to the call of the Chair.

[Recess.]

Senator PRYOR. The hearing will resume.

Actually, I do not have any more pertinent questions that I am going to ask of the General Accounting Office. Senator Levin?

Senator LEVIN. I just have a few questions, Mr. Chairman.

The first is about the provision relative to the agreement not being cancellable for the convenience of the Government. I am

aware that there was that side-bar letter that made an exception to the first 90 days.

Is this an unusual provision relative to cancellation for the convenience of the Government?

Mr. SOCOLAR. Yes, it is. Government contracts do contain termination for convenience clauses.

Senator LEVIN. And have you seen a contract, other than a property rental contract, which has a provision like this one?

Mr. SOCOLAR. I cannot recall any that deliberately would have omitted a termination for convenience clause.

Senator LEVIN. That deliberately omitted it?

Mr. SOCOLAR. That is right.

Senator LEVIN. As this one did?

Mr. SOCOLAR. That is correct.

Senator LEVIN. In your written testimony, you said that the Postal Service asserts that the five-year exclusive rights provision was intended to apply only to approved projects.

Do you see any basis for that assertion in the contract language?

Mr. SOCOLAR. Well, that is a point of controversy, I think, between the interpretation that is being given by Perot Systems and by the Postal Service. The controversy itself is what leads us to conclude that we might very well see claims from Perot Systems for projects that the Postal Service would have independently implemented on the premise that they had not approved those projects and therefore, were free to go ahead.

Senator LEVIN. Now, are you trying to state your answer in a way which is cautious in order to protect the interests of the Government in any future litigation?

Mr. SOCOLAR. No, no. I am stating my answer in terms of how I——

Senator LEVIN. Is there a problem—there may be, by the way—in answering my question? If there is, you can say so.

But do you see any basis in the contract language itself for an assertion that the exclusive rights provision was intended to apply to only approved projects?

Again, if this does, in any way, jeopardize the position of the Government legally in a potential litigation, then I can understand it. But if it does not—you know, I have read that language and I must tell you, I do not understand the basis for the claim. We have not heard yet from the Postmaster. He will give it to us, I am sure, in a few minutes.

But do you see a basis for that claim?

Mr. SOCOLAR. Actually, no, I do not see a straight-forward basis for that claim. The contract itself, the understandings between the parties were with the expectation that the projects would be approved unless there was a very good and specific reason not to approve them and if there were a good and specific reason not to approve them, one would hardly think that they would be implemented by the Postal Service.

The expectation, I think, was that anything that was to be implemented would be approved by the Postal Service.

Senator LEVIN. What do you make of this language—the Postal Service will not, without prior approval of the Perot Systems, im-

plement any project or portion thereof independently? What do you make of that language?

Mr. STEVENS. Senator Levin, I think one of the Postal Service's arguments is that that language occurs in the project implementation section of the contract and that its appearance there rather than elsewhere implies to them—or supports their understanding, which they have expressed to us, that the ownership applies only to approved projects, rather than just suggested ones.

I might add that in a conversation with Mr. Perot and his attorney, we did not get the same understanding from them on that matter.

Senator LEVIN. In other words, they do not concede that that is an exclusive right of theirs to implement projects during five years? I'm sorry—they insist that it is an exclusive right on their part to implement projects that they propose for a five-year period; is that correct?

Mr. STEVENS. I think the first way you phrased it was better—that they did not concede that the Postal Service's understanding was their understanding.

Senator LEVIN. So, as we understand it, the Postal Service is asserting that if they disapprove a project, they can still proceed independently with that project?

Mr. STEVENS. That is their understanding. That is the word they have used with us.

Senator LEVIN. And Perot does not concede that that understanding is correct?

Mr. STEVENS. They did not, in a conversation with us; yes, sir.

Senator LEVIN. They were asked specifically whether they made that concession?

Mr. STEVENS. Yes, sir. Mr. Engel of our staff did ask and Mr. Perot called in his lawyer at that point and they did not concede that point.

Senator LEVIN. This is a pretty important provision in this contract, is it not?

Mr. STEVENS. We believe it is; yes, sir.

Senator LEVIN. So, there may be disagreement even now between the Postal Service and the contractor as to the meaning of a key provision?

Mr. SOCOLAR. That is correct.

Senator LEVIN. That is all the questions I have. Thank you.

Senator PRYOR. Thank you, Senator Levin.

Do we have any idea when the first discussion was taking place or when the discussion about such an arrangement began? When was the inception of this, do we know?

Mr. SOCOLAR. It was shortly after Mr. Frank became Postmaster General.

Mr. STEVENS. The dinner reception or the first meeting between them. I think that was in early February.

Senator PRYOR. Is this where the idea was given birth, at that time?

Mr. STEVENS. As we have been told, the original assertion was that when Mr. Perot was contacted as a possible candidate for Postmaster General, he, in what he called to us as a Texas good-bye, said, well, I will be glad to offer any help I can and that that mes-

sage got to Mr. Frank, who, as soon as he had been designated, but not formally appointed, explored that suggestion with him in a personal meeting.

Senator PRYOR. I have no further questions. We really thank both of you very much for coming this morning. Thank you very, very much.

Mr. SOCOLAR. Thank you, Mr. Chairman.

Senator PRYOR. We will now ask Mr. Anthony Frank, Postmaster General; Mr. Kenneth Hunter, Associate Postmaster General—Systems; and Mr. Keith Strange, Director, Office of Procurement, to come forward.

Mr. FRANK. Good morning, Chairman Pryor and Chairman Levin.

Senator PRYOR. We welcome you here. Let me, if I might, make just a short statement. When I went to the Senate Floor to vote just a few moments ago, I was informed that at 11:30, I will have to leave here for a very critical meeting and so, Mr. Postmaster General, if you could make your statement and then allow me to ask you a few questions, then I am going to yield to Senator Levin and I am going to try to come back to this meeting before it is concluded. But I want you to have plenty of time to make whatever statement you need to make and, frankly, I think you need to make a pretty good statement right now.

TESTIMONY OF ANTHONY M. FRANK, POSTMASTER GENERAL, U.S. POSTAL SERVICE, ACCOMPANIED BY KENNETH J. HUNTER, ASSOCIATE POSTMASTER GENERAL, SYSTEMS, AND A. KEITH STRANGE, DIRECTOR, OFFICE OF PROCUREMENT

Mr. FRANK. Thank you, Mr. Chairman. My written testimony was submitted to you earlier this week and I would like it entered into the hearing record.[5]

Senator PRYOR. Without objection.

Mr. FRANK. I would like to go beyond that and provide you with a summary of my thinking about our contract with the Perot Systems.

In March, my first month as Postmaster General, I attempted to harness the unique talents of Ross Perot and his new company to save money for the Postal Service and, in turn, for the American people. For that, I have no apologies to make or regrets to express. However, my zeal resulted in the negotiation of a contract, perhaps more typical of the private sector than the Government. This was clearly a mistake that I hope it is not too late to rectify.

The results of this contract have been six-fold, it seems to me. One, to cause this hearing; two, to create the suspension of the contract; three, to cause the GAO report we just heard; four, to cause the Appeals Court review of the jurisdictional aspects; five, to spotlight our possible inclusion under additional Government procurement rules; and six, to consume a lot of time, energy, and morale of Postal Service senior management.

Taking each of these in turn. One, this hearing, I believe, can result in a better contract between the Postal Service and Perot

[5] See p. 52.

Systems without sacrificing the benefits. Two, I regret that the systems experts for Perot Systems have been idled by the suspension of the contract, but I believe it is still possible to resume the activities under Phase I by sometime next month.

Three, I am appreciative of the GAO's efforts to conduct its study promptly. We are now aware of their concerns and we believe we can overcome them by modifying the contract. Four, I am pleased that the Appeals Court has accepted this matter for review and I am confident that it will conclude that the independence granted us under the Postal Reorganization Act included removing us from the jurisdiction of the GSA.

Five, I am sorry that this effort has put the spotlight on our possible inclusion under procedures which have never applied to the U.S. Postal Service. I believe that these rules should not apply because they would undermine the authority granted to the Postal Governors and management by the Postal Reorganization Act.

As recently as May of this year, the GAO itself confirmed that authority, noting in a letter to Senator Pryor, and I quote,

> Congress has explicitly given USPS the authority, in the Postal Reorganization Act of 1970, to create its own procurement rules and regulations with the intent to permit USPS to operate like a private business when it is advantageous to do so. While USPS has only recently revised its procurement regulations to take advantage of its statutory authority to depart from the Federal purchasing procedures and practices it inherited, there is no question that Congress has urged it to move in that direction.
>
> Further, there is widespread interest in experimenting with ways to improve the Federal procurement system because of broad criticisms that current Federal procurement practices are overly complex, cumbersome, and restrictive.

Finally, it is unfortunate to have others in the Postal Service pay for the education of a new Postmaster General in the area of Government procurement.

Looking ahead, we believe—assuming the appellate court rules favorably—that it is possible to modify this contract substantially and to do so with the concurrence of Perot Systems. We have discussed a number of contract modifications that we believe to be responsive to the concerns that have arisen since we first announced our contract in June.

First, we will deal with concerns that the scope of the contract seems too unlimited. We propose to restructure the contract to allow Perot Systems to complete the Phase I studies and to supply support for the implementation of any projects identified. Perot Systems' role would include assistance in drafting RFP's and technical evaluations. Its role would also include integration and/or supervision as cost saving ideas are competed or implemented. All assistance would be provided on a task basis and only if required by the Postal Service. Our call.

Second, we will assure fair competition for the implementation of cost saving projects; that is, the Phase II activities under our original contract. These projects, only if approved by the Postal Service, would all be done on a fully competitive basis and Perot Systems would not and could not compete for any of this business.

Third, this contract will not result in obscene profits for Mr. Perot's firm. I believe it never would have. Perot Systems would work at cost until December 1989, as provided in his contract with General Motors, and thereafter, would work under more tradition-

al types of contracts, determined by the type of work to be done. All of the contract provisions for these activities would be in accordance with our contracting regulations.

Fourth, under this arrangement, the Postal Service would retain the rights to all ideas. Finally, the length of the contract would be adjusted. Perot Systems would receive a two-year contract with four two-year options to renew at our discretion. In addition, our ability to cancel the contract for convenience will be extended to cover the full term of the contract.

It is clearly the responsibility of the Postal Service to pay as little as possible for the services and products we buy. It is also our responsibility to manage our costs as effectively as possible to protect the interests of the American mailers who support us, not the taxpayers.

We believe we can meet these responsibilities through our own efforts to improve postal operations and through a modified contract that satisfies the concerns of the Congress and our other constituencies and which preserves the opportunity to bring Ross Perot and his people's unique expertise to bear on finding ways to make the Postal Service as efficient and cost-effective as practical.

Thank you. That concludes my additional remarks.

Senator PRYOR. Thank you, Mr. Frank.

The GAO report states, ". . . the contract as it now stands does not adequately protect the interests of the Postal Service, the ratepayers, or the Government."

Do you agree or disagree with that statement?

Mr. FRANK. Well, I disagree. It is an unusual contract. There is no doubt about it. It is a contract with an unusual man and an unusual firm in unusual circumstances. I believe we would not have entered into the contract if it did not fully protect the Postal Service and the people who pay postage.

Senator PRYOR. I agree with you that Mr. Perot is an unusual man. I also agree that we are in unusual times and circumstances. It is a very unusual contract; in fact, this is a very unusual hearing. Our good friend, whom I respect so much, Senator Stevens, does not like things like this because he thinks we are trying to micro-manage the Postal Service.

Do you think right now we are trying to micro-manage or interfere with the historical contracting authority of the Postal Service?

Mr. FRANK. Well, if these modifications that I have suggested today meet with a few or no objections, it seems to me that the spirit of this contract is not lost so therefore, we are not into micromanagement. Legislation that would make us comparable to Federal procurement rules would be a drastic disservice to almost everybody concerned; and yes, that would be micro-management.

Senator PRYOR. On August 5, the GSA Board of Contract Appeals issued a decision declaring the contract between the Postal Service and Perot Systems void *ab initio.*

Carl, I had not heard that since we were in law school, I think. I love that. I love that term. [Laughter.]

Later that day, Chairman Jack Brooks and Congressman Horton wrote you to implement the Board's decisions; in other words, cancel the contract.

Now, what is your response?

Mr. FRANK. Well, I would like to modify the contract. I think we have so much to gain. We really do need to drive our costs down at the Postal Service. It is not business as usual. We have an incredible disquieting, stirring around on the part of the major mailers who are afraid that costs are out of control at the Postal Service. We need to take some actions. This was my first action. It is one of many that I hope to take. But it is important to do this and I hope these modifications will satisfy Chairman Brooks and Mr. Horton, as it will these two Subcommittees.

Senator PRYOR. Will this Subcommittee have an opportunity to examine the final contract, the modified contract?

Mr. FRANK. Well, of course, that is always your privilege. I had anticipated that you would turn that responsibility over to the GAO, which has brought itself up to speed on the initial contract.

Senator PRYOR. Well, I do not want to micro-manage the Postal Service. We have enough problems without doing that, but I do think that we have got to be in the loop. I think this Subcommittee has got to be in the loop of those who look at this. I think that is our responsibility. We are an oversight committee. This Subcommittee is charged with the oversight of the Postal Service and we have to, I think, continue in this.

I want to thank you, Mr. Frank. I would not have left you right now at this moment, except for the fact that Senator Lloyd Bentsen wants to see me at 11:30 and I am going to go see Senator Bentsen, so I am going to turn this hearing over to Senator Levin. If possible, I will come back and visit some more. Senator Levin.

Mr. FRANK. Thank you, Mr. Chairman.

Senator LEVIN. I am going to just call a very brief, one-minute recess. Everybody, if they would, just stay there. I just want to talk to Senator Pryor for a moment.

[Brief recess.]

Senator LEVIN. Mr. Frank, I disagree with a number of things you said here today, as well as, obviously, this contract itself.

But to emphasize the positive first, basically what you are telling us is that you are going to ditch Phase II and redo it. You are going to do it with a different contractor or contractors. It is going to be competitive. Perot Systems is not going to be the contractor on Phase II. It is not going to be exclusive in anybody. The Postal Service can take Perot's ideas and implement them on their own if they want to.

You basically said, okay, we are going to do Phase II differently and Phase II is the principal problem that we have had. It is not $500,000 with somebody who is obviously creative to give you some ideas as to how to proceed. It is a sole source contract for that where his company is going to share in savings to an unspecified degree and he has got great leverage over you to determine the degree because it is an exclusive right in Perot Systems to implement those projects.

To emphasize the positive first, let me say that I am very glad that you have taken this tack. It comes as a surprise. It is very different from the testimony which you had submitted to us before, but I have got to tell you that I am glad you have taken this tack.

Mr. FRANK. Nobody is more glad than I am that you are glad. [Laughter.]

Senator LEVIN. One thing you said here today, which I must tell you I do disagree with, is your statement that this contract is more similar to one that would be entered into in the private sector. I used to be a lawyer in the private sector a long time ago. I never saw a contract in the private sector like this.

I never saw a contract where you handed to the other side a clause as general as this profit or savings sharing clause and then said, you have exclusive right to implement something, any savings we will share in an amount to be specified later that we will negotiate. What that does is give the leverage to the other party because he has got the exclusive right to implement.

The Postal Service cannot implement a project independent of Perot Systems under this contract. The way I read it, this is very clear. And by the way, Perot Systems, I think, would argue that that is the position. And yet, you left this big, unresolved issue of what the split is on the savings and gave the other party the right, under this contract, to define the baseline that the savings will be measured against.

So, Perot Systems, under the contract in Phase I, decides the baseline. They decide what is the current cost of this operation and then you negotiate what will be the cost of the new way to do it. You will negotiate what the share is of the savings—who gets how much of the savings—and that, to me, is a much blanker check than I have ever handed to anybody in a private negotiation.

So, I must say that I disagree with your statement that, well, we try to do it the way we would in private life and we cannot operate that way in the Government. I agree with you that you cannot operate that way in Government. On that part I do agree with you, but I disagree with the suggestion that this is the typical private contract. It is not typical from my experience.

That is not a question. That is a statement. Let me ask you now a question.

Mr. FRANK. Yes, sir.

Senator LEVIN. We asked you on July 28th, Chairman Pryor and myself, for all documents, including all minutes, notes, memoranda, correspondence, transcripts of meetings, or any other documents relating to the negotiation of the award of this contract. We were given some documents, but it is obvious from what was given to Senator Grassley last night that there are a whole lot of documents that we were not given in response to our letter to you asking for all documents.

Can you explain that?

Mr. FRANK. I really cannot.

Senator LEVIN. You cannot?

Mr. FRANK. We are not trying to withhold anything. It is a far-flung organization with a lot of documents going back and forth and, to the extent that we did not comply it, was absolutely nothing deliberate.

Senator LEVIN. So, it was your intention to supply us everything?

Mr. FRANK. Absolutely.

Senator LEVIN. Would you, just for the record, find out how it was that your staff or whoever it was that put together these documents, left out so many documents? I mean, I am not talking about one document, which does not have much in it. I am talking about

a whole lot of documents, a whole lot of notes on them which were turned over last night to Senator Grassley. We were glad they were, obviously. We are not competing with Senator Grassley.

The question is, why were these not turned over before? You can answer that question for the record, if you do not know the answer today.

Mr. FRANK. I will furnish that.

Senator LEVIN. Just a couple questions now on your testimony as you gave it to us this morning.

You said that you are going to negotiate modifications in this contract, in Phase II of this contract. How confident are you that you are going to succeed? Are you saying that you have a high degree of confidence that you are going to succeed along the lines you have outlined here this morning?

Mr. FRANK. Yes.

Senator LEVIN. Does your success depend upon the court decision going one way or another?

Mr. FRANK. It very definitely does, Mr. Chairman. We are anticipating a favorable ruling on the jurisdictional matter. If the jurisdictional matter is decided against us, then we do not have a contract.

Senator LEVIN. And there is not even a Phase I?

Mr. FRANK. That is right.

Senator LEVIN. But if you win the court decision, then you are highly confident that you can revamp Phase II; is that correct?

Mr. FRANK. That is correct.

Senator LEVIN. All right. You said that the contract is suspended. Would you tell us a little more precisely what that means? Is that some kind of a mutual agreement with Perot Systems?

Mr. FRANK. No. That was an order from the GSBCA, which, of course, we say we are not under the jurisdiction of, but we were advised legally by the Justice Department that our standing in the court would be enhanced if we complied with the suspension order.

Senator LEVIN. Did you have any negotiations with Perot Systems about that suspension?

Mr. FRANK. Not that I am aware of.

Senator LEVIN. Does that hold the 90-day time period?

Mr. FRANK. It holds it; right.

Senator LEVIN. Can it hold it without the agreement of Perot Systems?

Mr. FRANK. Yes.

Senator LEVIN. You have been advised, in other words, that the clock is stopped on the 90 days, even though Perot Systems has not agreed that the clock would stop?

Mr. FRANK. That is what I have been advised; right.

Senator LEVIN. Was that the Justice Department or your own lawyers that advised you of that?

Mr. FRANK. Our own lawyers.

Senator LEVIN. Is it your position that under Phase II of the contract, that Perot Systems does not have the exclusive right to carry out those projects which they recommend in Phase I? That if, in fact, you do not use them, do not agree on the profit or savings sharing, that then you are free to independently proceed?

Mr. FRANK. Yes.

Senator LEVIN. Can you tell me what language in the contract you are referring to for your position?

Mr. FRANK. With your permission, I will ask Mr. Hunter to do that.

Senator LEVIN. Sure. Mr. Hunter?

Mr. HUNTER. I think it goes to the same thing that GAO referred to. Our interpretation is where that appears in the contract is relevant with regards to those items that we agree to implement. And of course, the agreement to implement addresses the recommendations, not the controllor decisions that Perot has authority for with regards to the sharing of the savings, as well as the merit of the idea.

Senator LEVIN. How can you reach that conclusion when the language seems so clear that "The Postal Service will not without the prior approval of Perot Systems, implement any project or portion thereof independently"?

How do you reach a conclusion that you can implement a project independently—and the word project is with a capital P and has been defined in the contract as meaning projects which they have recommended in Phase I. What do you do with that language?

Mr. HUNTER. Well, that is our interpretation of it. We acknowledge——

Senator LEVIN. But you cannot interpret it out of existence. It is there.

Mr. FRANK. But, sir, it deals with that portion of the contract, as I understand it, once the two firms had agreed on a project, then that idea would have exclusivity and only then.

Senator LEVIN. It says any project. It does not say any project approved by you. It says any project and your own documents show a lot of staff reservation about giving this kind of exclusive right to Perot.

Mr. HUNTER. Well, again, our interpretation is that. Now we acknowledge that there is concern about that as has been raised by you and by others and that is the reason for the clarification that is proposed by the Postmaster General. I would also like Keith Strange, the Contracting Officer, to have an opportunity to address that.

Mr. STRANGE. Senator, certainly as has been pointed out, shortly after the contract was executed, we became aware through a number of different ways that there were various interpretations being taken regarding that particular provision. I entered in discussions with Perot Systems Corporation and their President, whose name is Pat Horner, to clarify that.

Mr. Horner clarified with me the intent of Perot Systems was that that provision applied only to specific implementation projects which were accepted by the Postal Service. The contract has not been formally modified in that respect yet, but that is certainly the agreement of the parties, at least verbally, on the intent of that provision.

Senator LEVIN. Is that what they told GAO, according to GAO's testimony?

Mr. STRANGE. I understand that GAO spoke to Mr. Perot and not to Mr. Horner and I cannot resolve that difference.

Senator LEVIN. So, what you are saying is, Perot Systems told you that the exclusive right to implement applies only to those projects which you are proceeding with, with them?

Mr. STRANGE. That is precisely correct.

Senator LEVIN. Well, I am glad to hear it. It is a complete turnaround, not just in the language of the contract, but in the history of the negotiations. It does not make any sense. What does exclusive right mean? What does the word exclusive mean?

Mr. STRANGE. An exclusive right to those projects which we accept and their specific implementation ideas.

Senator LEVIN. You mean, they have the exclusive right to carry out projects which you agree that they would exclusively carry out?

Mr. STRANGE. Yes.

Senator LEVIN. That is a very unusual definition of the word exclusive. There is no use going into this a lot further, as far as I am concerned, if this is going to be modified out of existence, which is what it ought to be. *Ab initio* is a word I love, too, not as much as Senator Pryor. He has a particular fondness for Latin phrases. [Laughter.]

But since it is going to be modified so radically, then it seems to me there is no use pursuing what the meaning is of a phrase which is going to no longer exist in a contract. So, I will just pursue two more lines of questioning.

One, the GAO has testified this morning that you did not comply with your own manual. You were here, I believe, Mr. Frank, during that?

Mr. FRANK. Yes, sir.

Senator LEVIN. Do you disagree with their testimony?

Mr. FRANK. I believe we complied. We would not have done it otherwise.

Senator LEVIN. Do you believe that you developed a procurement plan?

Mr. STRANGE. Senator, could I address those questions, please?

Senator LEVIN. Sure. If the Postmaster General wants you to, by all means.

Mr. STRANGE. On the issue of the procurement plan, we do think that we followed our regulations. The Procurement Manual says that an individual procurement plan is required on certain programs, depending on procurements, depending on the dollar amount, except for unanticipated requirements. The Procurement Manual's requirement for a procurement plan was really envisioning the system of normal requirements, repetitive requirements, which are developed through in advance of the normal budgetary process.

I think it is clear that this requirement did not develop during the normal budgetary process and it was an unanticipated requirement. So, I think the Procurement Manual does not require a procurement plan in this instance.

Senator LEVIN. Does not require a procurement plan for what?

Mr. STRANGE. In this particular instance. If you look at the elements of the procurement plan which addresses things like measures to obtain competition, evaluation criteria, and other aspects, I think that is a reasonable interpretation.

Senator LEVIN. So, when your Chapter Two says procurement planning, including market research, must be done to ensure that the Postal Service's needs are met in the most effective, economical, and timely manner, you are saying that does not cover noncompetitive, sole source contracts?

Mr. STRANGE. No, I am saying it does not cover unanticipated requirements.

Senator LEVIN. Where does it say that?

Mr. STRANGE. It says that in—I do not have the exact reference in front of me, but it is in Section Two of the Procurement Manual.

Senator LEVIN. Why is this an unanticipated requirement? I mean, as soon as the Postmaster General came into office just about, he was saying, we would like to hire this unique gentleman to give us services. What is unanticipated about it? Let's try to work out a way to get Perot and his new company involved in this. Why is that unanticipated?

Mr. STRANGE. In terms of the procurement process and the involvement of the Office of Procurement, we got involved about one week before negotiations started.

Senator LEVIN. You mean it was not anticipated by you? You were caught by surprise.

Mr. STRANGE. By the Office of Procurement. Yes. And the——

Senator LEVIN. The Service was not caught by surprise; you were caught by surprise.

Mr. STRANGE. Well, certainly as Contracting Officer with responsibility to develop the individual procurement plan, it is the responsibility of the Contracting Officer. From that standpoint, I think it was clearly unanticipated.

Senator LEVIN. And when did it come to you?

Mr. STRANGE. It came to me about the last week of April, I believe.

Senator LEVIN. And the meeting with Mr. Perot was in February?

Mr. STRANGE. The meeting with Mr. Perot?

Senator LEVIN. The Postmaster General's meeting with Mr. Perot was in February?

Mr. FRANK. My first contact with him was before I took office and it was in February.

Senator LEVIN. I do not see, with any stretch of the imagination, that this is an unanticipated need of the Postal Service. When you got the GAO saying you did not even follow your own manual, you ought to listen. You see, you have an argument that you are not covered by the Brooks Act. That is going to be decided in a court; not here.

But when you have the GAO saying that your own manual was not followed, they do not frequently come forward with testimony so conclusionary as it was here about whether you followed your own manual and as to whether or not this contract is in the best interest of the Government.

They were very, very clear this morning on those subjects and I would suggest that you get together with the GAO because we rely on them pretty heavily. When they say you did not follow your manual and when the language of the manual seems clear, there is a real problem.

Mr. STRANGE. Senator, I would certainly be glad to get together with the General Accounting Office on that issue. We had a number of discussions as they went through their review and, frankly, the testimony this morning was the first indication I had that they felt we had not followed our manual.

Senator LEVIN. Mr. Frank, what efforts did you make to see what other companies or individuals could provide this service?

Mr. FRANK. None.

Senator LEVIN. Shouldn't you have, before you concluded that Perot Systems was unique, made some kind of an inquiry as to what other companies or individuals also had creative talents like Mr. Perot does?

Mr. FRANK. Well, it is possible. These are not the only ideas we need. It is awfully hard to compete for ideas. I had a man with a proven record, a man that could not show a profit for a year and a half. That is certainly unusual.

Senator LEVIN. Aren't there other people with proven track records? Aren't there other creative people in companies——

Mr. FRANK. Well, I am sure there are and we are looking for them and there are many other areas of the Postal Service that need study and work and input. We have to start somewhere.

Senator LEVIN. Isn't the place to start to look, see what your needs are and then to see what entities there are out there that can meet those needs? I think that everybody on these Subcommittees that are jointly holding this hearing today would support you in getting outside advice. You are not going to find a lot of opposition here. It is how it was done here.

But, isn't the way to proceed here logically and fairly to everybody since you are spending taxpayers' and ratepayers' dollars, to see what needs do we have here? We have got these problems. Who out there can creatively address them?

Mr. FRANK. Well, I am sure that we will be doing that. I must say that being the only client of this new firm was a matter of considerable importance to me. We would not have any brand new MBAs who are being educated at our expense. They cost just as much as experienced people. And we would not be just another client. We would be the only client and the flagship client, even when other clients came.

I think that has a great deal of importance. Perot and his people have a great deal of pride, drive, emphasis. They like to succeed. Those are the type of people I would like to see the Postal Service connected with. As I say, we have a lot of ideas, a lot of needs for ideas and we will be looking, particularly with your encouragement, at other ways to do that.

I have got to move and move rapidly to drive these costs down and maybe this was not a perfect way to do it. On the other hand, I think having Perot associated with us is a plus, I still do. And we must explore a whole bunch of avenues in order to do what is right for the American people.

Senator LEVIN. What does this provision mean, that the contractor will notify the contracting office whenever the contractor enters into an agreement to provide any professional advice, representation, or assistance to any non-Postal Service client?

Mr. STRANGE. I think I should address that, Senator, if I may.

I believe that is a quote from one of the conflict of interest provisions in the contract and it has to do with avoidance of a potential situation of the contractor being involved with a competitor of the Postal Service.

Senator LEVIN. That suggests that he would have other clients.

Mr. STRANGE. There was a possibility; yes.

Senator LEVIN. I understand from your testimony that you would be the only client?

Mr. FRANK. My testimony was, we would initially be the only one and subsequently, we would be the flagship client.

Senator LEVIN. I see. So, there was no commitment that you would be the only client?

Mr. FRANK. Excuse me?

Senator LEVIN. There is no commitment anywhere that you would be the only client?

Mr. FRANK. Not in the total history of Perot Systems, but initially, we would be.

Senator LEVIN. You would be the first client, is that an accurate way to phrase it?

Mr. FRANK. The first and the only——

Senator LEVIN. For how long would you be the only client?

Mr. FRANK. I believe easily through Phase I.

Senator LEVIN. Was there any assurance of that? In other words, for the first 90 days, you would be the only client?

Mr. FRANK. That is right. Then would come, in the old contract, the implementation phase which would, of course, require more people, more resources, which only more clients could provide the base for.

Senator LEVIN. But there is no assurance that you would be the only client, even during Phase I, or was there an assurance?

Mr. FRANK. My recollection is there was assurance.

Senator LEVIN. In the contract or orally?

Mr. FRANK. Orally.

Senator LEVIN. Will you be using the ordinary competitive procedures relative to Phase II under the description of Phase II as modified, which you have given us today?

Mr. FRANK. Yes.

Senator LEVIN. What we would like to do—and I am speaking here on behalf of Senator Pryor as well as myself—is to adjourn this hearing. We would like to see how this unfolds because right now, obviously, you do not have a new agreement.

Mr. FRANK. And we will not even start on it, obviously, until after the court——

Senator LEVIN. After the court decision.

Mr. FRANK. Right.

Senator LEVIN. I would urge you just to double check, if I may say so, with the lawyers, on this question as to whether or not the clock is stopped on the 90 days. Since you are a Government entity, I would like you to be very—your lawyers to be clear and I would urge you to get Perot Systems' agreement on that explicitly.

Mr. FRANK. We have received it explicitly, but we can get it in writing.

Senator LEVIN. Yes, I think that, frankly, there should be some kind of a joint, mutual agreement on that issue. Otherwise, you

might be in a position where the 90 days can run, the court can come down with a decision that the Brooks Act does not apply, and then you will be in a position where you have got a contract and you cannot cancel for the convenience of the Government unless both sides have agreed you cannot, but you can. So, I would urge you that that be specific.

But what we will do is, we will adjourn this so we can keep in close touch with you and we would appreciate two things from you, if you would. One is the answer to that question about the materials. The second one would be that you and your staff keep in close touch with these Subcommittees as your negotiations proceed.

We are not going to be negotiating with you at the table at all. You are going to be doing the negotiating, not us. Senator Stevens says we do not want to micro-manage this, but we do have a procurement system and there are questions as to whether the Postal Service should be in or out of the general procurement system. So, there is a legislative function, a policy function to be performed here and your keeping in close contact, informationally—again, we do not want to be nor do we have any business being at the table with you when you negotiate this with Perot Systems. But if you would just keep us informed, that would be very helpful.

Mr. FRANK. Yes, we will.

Senator LEVIN. Let me say that I believe what you have decided to do is a very significant step forward for you and for the Postal Service. By the way—I think I am speaking for everyone I know—we have heard nothing but good things about you personally. I want you to know that.

Mr. FRANK. Thank you.

Senator LEVIN. You have a lot of esteem on this Committee and the disagreement that exists over this contract that was entered into in no way reflects the views that any of us have relative to the new Postmaster General. Your reputation is a fine one and although this contract was a mistake, we hope that is now going to be rectified.

The outline that you have given us for the change and the rectification in it is a positive, very major shift in direction. We have not had a chance, obviously, to review the details, even of your outline of it, and we will then adjourn these hearings so that we can have that opportunity and wish you well as you renegotiate the contract. Senator Stevens?

Senator STEVENS. I am sorry I was late, Mr. Postmaster General. As I said before, the Defense Appropriations bill is on the floor. As I understand it, you have made that second statement that was delivered to us this morning; is that correct?

Mr. FRANK. Yes, sir.

Senator STEVENS. And you are going to await the outcome of the appellate court before proceeding now?

Mr. FRANK. We think it is terribly important to do that.

Senator STEVENS. Well, I concur in that. Assuming that your position prevails in the Court of Appeals, you then intend to seek modifications in Phase II or Phase I?

Mr. FRANK. Phase II.

Senator STEVENS. And proceed with Phase I as originally contemplated?

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Mr. FRANK. Yes, sir.

Senator STEVENS. I want to commend you again. I never met Ross Perot until you entered into this, so maybe that is one of the side lines of this, as far as my personal life is concerned. I agree with your decision to seek out the unique talents of not only Mr. Perot but of the group that he is capably putting together. In view of the change in management of EDS, it is a good decision and I hope that you prevail in the Court of Appeals.

Mr. FRANK. Thank you, sir.

Senator STEVENS. Thank you.

Senator LEVIN. Just one more question.

Mr. FRANK. Yes, sir.

Senator LEVIN. If you are unable to renegotiate a satisfactory Phase II, getting out of Phase II at all, but in any event, if you cannot negotiate according to the outline you have given us here today, is it your intention, during the 90-day period, to cancel for the convenience of the Government?

Mr. FRANK. Yes.

Senator LEVIN. We are going to adjourn this hearing then to an unspecified date so that we can review the outline you gave us today. We thank you all for coming and we will stand adjourned.

Mr. FRANK. Thank you, sir.

[Whereupon, at 12:00 p.m., the hearing was adjourned, subject to the call of the Chair.]

APPENDIX

STATEMENT OF SENATOR CHARLES GRASSLEY

TESTIMONY BEFORE

THE SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE AND CIVIL SERVICE

AND

THE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

AUGUST 10, 1988

Thank you, Mr. Chairman, for allowing me to participate in today's hearing involving a matter of importance to all taxpayers. While I am not a member of this Committee, I have worked with both you and Senator Levin in the past on a number of government procurement issues. Many of those issues have involved the Defense Department, where the absence of competition has been obvious to the public and detrimental to the national interest. We have sought to remedy the ills of government procurement through the tried-and-true practice of competitive bidding.

The issue before this Committee today, Mr. Chairman, is no different. We all know too well that government procurement rules are not perfect. We also know that competition, in and of itself, will not cure all government contracting abuses. However, no one has discovered a method that more adequately protects the taxpayers interests than does full and open competition. We, as a legislative body, have repeatedly affirmed this belief through the laws we have passed. And the record clearly shows that competition works. Whenever competition is possible, the best interest of the taxpayer demands that it be employed.

It is a long-desired goal that the Postal Service provide for this country more efficient and less costly operations. That was my hope when I first learned of the contract between the Postal Service and the Perot Systems Corp., and before I became familiar with the contract. Upon scrutiny of the contract and details surrounding the award, a totally different picture emerged.

This contract suddenly loomed as a potential wolf in sheep's clothing. The absence of competition, the sole-source method without justification, the institutional conflict of interest, the unspecified savings/profits arrangement, and other problem areas of the contract..... These all contributed to an undeniable violation of what we in Congress have fought hard over the years to prevent.

As I understand it, Mr. Chairman, the Postal Service's new procurement regulations allow non-competitive purchases only under certain limited circumstances. These include, for instance:

a. when there is an unusual and compelling urgency or
b. when competition is not in USPS's interest

In his written testimony, Mr. Frank does not specify which of these circumstances were present as a justification for awarding a sole source contract. The General Accounting Office report states that an inadequate justification was given, and that a provision to waive the justification was not exercised.

What <u>is</u> offered by Mr. Frank, however, is the statement that Perot Systems would provide a new and fresh approach to solving the Postal Service's problems. The question, it seems to me, Mr. Chairman, is whether that is justification enough to sidestep the Postal Service's "new and fresh" procurement regulations, and to sidestep the obvious benefits to the taxpayers from the rigors of competition. It is apparent that numerous contractors could have met the contract's requirements, or at a minimum should have been given a fair shot.

As you know, Mr. Chairman, several companies challenged the Postal Service's award to Perot Systems before the General Services Administration Board of Contract Appeals. Both Perot Systems and the Postal Service failed to turn over numerous internal documents during the Board's discovery procedures. At my request, the GAO recently obtained at least some of these documents which were provided to me late yesterday. The documents paint a disturbing picture of the process by which this contract was awarded.

The Postal Service documents show that within a week of assuming his job as Postmaster General, Mr. Frank advised a subordinate that he anticipated "making money available for the company of [Mr. Perot]." At this time, the Postal Service had not even determined what, if any work, Mr. Perot could perform. Mr. Frank's seemingly premature decision, prior to any contract negotiations, might suggest favoritism toward Mr. Perot. It also opens the Postal Service to the obvious charge, whether correct or not, that at least part of the motivation behind this contract was not to save money for the Postal Service and the taxpayer, but to make money for Mr. Perot.

The Postal Service also apparently sought out creative methods for transferring money to Mr. Perot, according to the documents obtained. When asked to devise ways of funding a contract for Ross Perot, the controller of the Postal Service advised that money was no problem, and that if necessary the Postal Service could revise its deficit estimates to come up with whatever cash was needed. Here is a direct quote from one document:

> [Mr. Porras] advised that the Department of the Controller could develop sources for whatever funding is required. In the simplest case, the revised estimate of the deficit for the

year could be adjusted to cover the necessary amount, but other options are available depending on the dollar amount needed.

Again, Mr. Chairman, this is disturbing in the sense of potential public outrage. During the same period when the Postal Service pleaded poverty as justification for a massive postage rate increase, it was also willing to "cook the books" to come up with money for Mr. Perot, if these documents are correct.

As I mentioned earlier in my testimony, Mr. Chairman, we should be wary of any wolves in sheep's clothing. This contract should be examined for both the appearance and the reality of favoritism, as well as unsupported restrictions on normal competitive procurement. The decision to enter into this contract appears to have been made before the Postal Service decided what the contractor was supposed to do. And the contract terms provide no protection against procurement abuses we have seen in the past associated with sole source contracts.

In my view, Mr. Chairman, given the facts already in the public domain, the fairest of all possible options would be to wipe the slate clean, subject the contract to competition, and this time try to ensure the best possible deal for the taxpayers of this country. Knowing of your outstanding record in procurement reform, Mr. Chairman, I have every confidence that this Committee will do whatever it can to assure a just resolution of this matter. I thank you again for inviting me to participate in this hearing and I look forward to working with you on this issue.

United States General Accounting Office

GAO Testimony

For Release
On Delivery
Expected at
10:00 a.m. EDT
Wednesday
August 10, 1988

The Postal Service's Sole-Source Contract with Perot Systems Corporation

Statement of
Milton J. Socolar, Special Assistant to the
Comptroller General of the United States

Before the
Subcommittee on Federal Services, Post Office, and Civil Service, and
Subcommittee on Oversight of Government Management
Committee on Governmental Affairs
United States Senate

GAO/T-GGD-88-50

GAO Form 160 (12/87)

POSTAL SERVICE CONTRACT WITH PEROT SYSTEMS CORPORATION
SUMMARY OF STATEMENT BY
MILTON J. SOCOLAR
SPECIAL ASSISTANT TO THE COMPTROLLER GENERAL
UNITED STATES GENERAL ACCOUNTING OFFICE

On May 27, 1988, following about 3 months of discussions and negotiations, the Postal Service signed a sole-source contract with Perot Systems Corporation to devise and implement efficiency improvements in postal telecommunications, delivery services, revenue protection, transportation, and mail transportation equipment.

As authorized by the Postal Reorganization Act, postal procurement regulations differ significantly from standards that govern other federal agencies. However, both encourage competition and neither prohibits sole-source contracts that are properly justified and approved. The concept of shared savings is also compatible with postal and general federal requirements.

GAO found that the Postal Service sought to comply with the requirements of its new procurement manual in awarding the Perot contract. Nonetheless, the contract is loosely written in key particulars and does not adequately protect the interests of the Postal Service, its ratepayers, and the government. GAO's principal concerns fall in four areas:

-- The contract gives Perot Systems ownership of the ideas embodied in projects it will propose and reserves to Perot for 5 years the right to implement any portion of each proposed project.

-- The contract provides for the sharing of savings but specifies no ceiling on Perot's proportional share. The extent of sharing is to be determined through project-by-project negotiation with Perot in a strong bargaining position.

-- The contract, contrary to standard government practice, limits the ability of the Postal Service to terminate for convenience and provides no cost limit. In the event the Postal Service does terminate for convenience, Perot is entitled to 50 percent of its share of savings for the remaining term of the 10-year contract.

-- The contract was awarded on a sole-source basis without adequate justification.

Chairman Pryor, Chairman Levin, and Members of the Subcommittees:

We are pleased to be here today to assist the Senate in its inquiry into the Postal Service's award of a sole-source contract to Perot Systems Corporation on May 27, 1988. My testimony covers the following areas which we agreed to address in response to your request and the sense of the Senate resolution adopted on June 22:

-- How the contract came about;

-- Whether the Postal Service complied with its own procurement regulations, particularly those which govern competition in contracting, in awarding the contract to Perot Systems;

-- Whether unique features of the contract adequately protect the interests of ratepayers, the Postal Service, and the government in general;

-- Precedents for the shared savings concept in the contract that allows Perot Systems to share in the savings from projects it proposes and implements.

We reviewed the contract files and other documents relating to the contract and we interviewed Mr. Perot and responsible Postal Service officials including the Postmaster General; the

Assistant Postmaster General for Procurement and Supply; and the Contracting Officer, who is also the Director of the Office of Procurement.

Since completion of our review, the General Services Administration Board of Contract Appeals (GSBCA) has issued a decision holding that the contract between the Postal Service and Perot Systems is void. The principal ground for the Board's decision is that the Postal Service, insofar as it engages in automatic data processing equipment contracts, is covered by the Brooks Act. Therefore, the Board ruled that, under the Brooks Act, the Service is subject to the jurisdiction of GSBCA and that, in awarding the contract, the Postal Service failed to satisfy several of the Brooks Act's requirements. The Board also found that Postal Service had not followed all applicable provisions of its own procurement manual.

The Postal Service strongly disagrees with GSBCA's view of the applicability of the Brooks Act, maintaining that all Postal Service contracts are subject only to the provisions of its own procurement manual. Our work was conducted on the basis of the Postal Service's view that its own rules govern its contracting authority.

BACKGROUND ON THE CONTRACT
WITH PEROT SYSTEMS CORPORATION

Soon after his selection, Postmaster General Frank was told by a member of the Postal Service Board of Governors (Mr. Setrakian) that H. Ross Perot might be interested in helping him improve the Postal Service. Mr. Perot had been one of the people contacted by the Board's Selection Committee in its search for a new Postmaster General. In response to this suggestion, Mr. Frank visited Mr. Perot in Dallas and invited him to address the Postal Service Board of Governors at an informal dinner meeting on March 7, 1988. During the meeting Mr. Perot shared his management and leadership philosophies and expressed an interest in the challenges faced by the Postal Service. Following the dinner meeting Mr. Frank arranged for Mr. Perot to tour several postal facilities in the Dallas area on March 17-18, 1988.

Both Mr. Frank and Mr. Perot remained interested in reaching an agreement and in late March and early April 1988 senior postal officials internally discussed the pros and cons of contracting with Perot Systems Corporation and, if so, what areas should be included in the contract. On April 25, 1988, the Senior Management Council made the decision to continue discussions with Mr. Perot.

A Postal Service negotiation team composed of senior officials representing the Management Information and Research Technology Group, Office of General Counsel, Office of Procurement, and the Special Assistant to the Deputy Postmaster General, traveled to Dallas to meet with Mr. Perot. The first meeting took place on the evening of April 28, 1988, and intermittent negotiations continued with Mr. Perot and his attorneys through May 25, 1988.

On that date, Postmaster General Frank met with the negotiation team to discuss the status of the negotiations. Following a discussion of the pros and cons of the proposed agreement, he made a decision to proceed with the contract.

On May 26, 1988, final contract language was agreed to, the Director of the Office of Procurement prepared a recommendation to award the contract, and a noncompetitive award was approved by the Assistant Postmaster General for Procurement and Supply, Mr. John Davin. Mr. Davin's approval pointed out that because of the unusual nature of the study and implementation phases covered by the contract, he would require a "full business review" before making a decision to proceed beyond the study phase with any project.

The contract, which is dated May 26, 1988, was signed by the Contracting Officer (Mr. Strange) and was accepted by Mr. Perot for Perot Systems Corporation on May 27, 1988.

The agreement is a two-phase contract with an initial study period expected to last 90 days. During the initial phase Perot Systems will study five major Postal Service functions for ways to increase efficiency and cut costs. The functional areas are transportation, telecommunications, delivery services, revenue protection, and mail transportation equipment. Upon completion of each study Perot Systems Corporation is required to submit a report, including among other things:

-- a statement of work for Perot Systems Corporation operational or management services,

-- an implementation plan and schedule for each project,

-- a description of current Postal Service base costs for each operation, and

-- a proposal for computing and sharing the savings resulting from operational improvements.

The Postal Service will then decide whether to proceed with any study proposal into implementation. Each implementation project will be separately negotiated and approved.

COMPLIANCE WITH POSTAL
PROCUREMENT MANUAL

When the Postal Reorganization Act was passed in 1970, the Postal Service was exempted from contracting laws applicable to federal agencies. The service then issued its own procurement regulations and has issued a second procurement manual which became effective on June 1, 1988. Because the contract was not to start until June 6, 1988, the Assistant Postmaster General for Procurement and Supply approved application of the new manual notwithstanding that the contract was signed in May.

We found that the Postal Service sought to comply with the requirements of its new procurement manual in awarding the Perot Systems contract. The new manual departs significantly from standards that govern procurement by other federal agencies. It adopts what the Postal Service considers are the best features from private and public procurement practices. It establishes a general policy of "adequate competition from qualified sources" in contrast to the federal policy of "full and open" competition. Both the new postal manual and federal procurement regulations permit noncompetitive contract awards when properly justified and approved. Finally, apart from their specific content, the postal manual is a more directory document in its application in contrast to the mandatory structure of federal procurement regulations.

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These differences aside, it is our opinion that the contract is loosely written in some key particulars. The contract as it now stands does not adequately protect the interests of the Postal Service, the ratepayers, or the government. We have four principal areas of concern:

-- Perot's rights to ideas,

-- Lack of a ceiling on Perot's share of savings,

-- Limited ability of the Postal Service to terminate for convenience, and

-- Adequacy of the sole-source justification.

UNUSUAL FEATURES OF
THE PEROT SYSTEMS CONTRACT

The Postal Service contract with Perot Systems contains several provisions that constitute a marked departure from standard practice.

Perot's Rights to Ideas

The contract gives the Postal Service the right to approve or reject projects that are proposed by Perot Systems Corporation. However, the contract establishes a "mutual expectation" that each project will be approved unless the Postal Service reasonably determines that implementation would be contrary to its business objectives and policies.

The contract also provides that the Postal Service will not, without prior approval of Perot Systems, implement any project or portion thereof independently at any time prior to the fifth anniversary of the effective date of the contract. If a project is implemented after the fifth anniversary, Perot Systems is entitled to compete for the contract to the same extent as any other party.

The contract does not specify what is to happen in the event the Postal Service disapproves or delays the implementation of a proposed project. While the Postal Service has the right to reject projects under the contract, Perot Systems also has rights to projects it proposes. As we read the contract, the Postal Service may not, without Perot Systems approval, implement any project or portion of a project proposed by Perot Systems but not approved by the Postal Service. The Postal Service asserts that the 5-year exclusive rights provision was intended to apply only

to approved projects. We are concerned that this portion of the contract could result in reduced management flexibility for the Postal Service. Because the contract is, at best, unclear, we are also concerned about the possibility that Perot Systems could submit future claims for projects or parts thereof that were not approved by the Postal Service during negotiations for implementation but were subsequently initiated by the Postal Service.

Further, the contract is unclear as to Perot's rights to ideas that are either similar to or based in whole or in part on previous work or studies that postal employees or others have done. This could be a problem in the future unless Perot Systems' ideas are so unique and novel as to never have been considered before by the thousands of people involved in or familiar with postal operations.

These contract ambiguities are invitations for protracted litigation, with the potential effect of undermining the Postal Service's ability to institute needed cost efficient reforms.

Lack of a Ceiling on Perot's
Share of Savings

The contract calls for the Postal Service and Perot Systems to share the savings resulting from projects beginning December 1,

1989. This date was selected because Mr. Perot's agreement with General Motors prohibits him from for-profit enterprises until then. However, the contract does not contain limits on how large a share either party would receive. During negotiations, Perot Systems argued strongly for a 50-50 split in the contract, but Postal negotiators felt that proportion might result in inordinate profits for Perot. The respective shares on a percentage basis are now required to be agreed upon project-by-project prior to commencing each project.

Lack of an advance agreement on how the savings will be shared has contributed to speculation that Perot Systems could make very high profits on this contract. The contract places Perot Systems in a very strong bargaining position by forbidding Postal Service implementation of the projects independent of Perot and by establishing a "mutual expectation" that reasonable projects will be approved.

Limited Ability of the Postal Service
to Terminate for Convenience

Both Postal Service and other government contracts generally allow federal agencies to terminate for convenience without liability for breach of contract damages any time a contracting officer determines continuation of the contract is not in the best interest of the government. They also establish a limit on

cost to the government. The Perot Systems contract contains no cost limit provision. Further, it prohibits the Postal Service from terminating for convenience during the period beyond the 90-day study phase until 2 years after the effective date of contract award. A separate agreement between Mr. Perot and the Postal Service permits the Service to terminate the contract during the study phase if the contracting officer determines that continuation is not in the best interest of the Postal Service. The modified termination for convenience clause, which applies after the first 90 days, entitles Perot Systems to 50 percent of the share of savings that would have been paid had the contract not been terminated prior to the end of its intended 10-year life.

According to postal officials, the termination for convenience clause was modified because Mr. Perot wanted to be guaranteed the opportunity to implement his ideas and because Perot Systems, pursuant to Mr. Perot's prior agreement with General Motors, could make no profits for 18 months. Termination within that period would have allowed Perot Systems no profits for its work. The failure to use the standard termination for convenience clause in itself may have presented only a limited risk. This failure, however, coupled with the guarantee to Perot Systems of 50 percent of its projected savings share for the remaining years of the contract if the Postal Service should terminate at some point, is cause for concern.

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Adequacy of the Sole-Source Justification

The Postal Service prepared a formal sole-source justification that was approved by the appropriate postal officials, but we found the justification unconvincing and that it did not comply with applicable Postal Service requirements.

The written justification focuses on the unique capabilities of H. Ross Perot for this effort but fails to establish that he is the only one who can perform the required work and fails to consider the qualifications of others. It expounds on his skills, image, past track record, and on his decisiveness and innovativeness. While the justification emphasizes Mr. Perot's personal qualities, the contract does not require any commitment of his time.

The Postal Service has authority to deviate from any of its manual provisions, including those having to do with competitive and noncompetitive contract awards, even, apparently, after award of a contract is challenged. See Morgan Associates v. United States Postal Service, 511 F.2d 1223 (2d Cir. 1975). In the Perot contract, the Postal Service did not seek to deviate, but in our view, its attempt to justify the sole-source award plainly failed.

PRECEDENTS FOR THE
SHARED SAVINGS CONCEPT

You also asked us whether there are precedents in federal contracting for the shared savings method of compensation embodied in the Perot Systems contract.

There are precedents for the shared savings concept in federal contracting. Value engineering, for example, provides for the sharing of savings resulting from engineering change proposals suggested by contractors and accepted by the government. Sharing in the savings resulting from contract costs ultimately being less than a set target would be another example.

Yet another example where the shared savings concept is being applied is in the area of energy savings. The Postal Service awarded the federal government's first shared energy savings contract in December of last year. This contract is a lighting retrofit project for the San Diego General Mail Facility. It calls for retrofitting 2,292 fluorescent lighting fixtures with energy-efficient ballasts, reflectors and new lamps. The Postal Service expects its share of savings to be about $600,000 during the 7 years of this contract. While this contract is an example of sharing savings, we do not believe it is similar to the Perot Systems contract because (1) it was competitively awarded and (2) the winning contractor was required to incur all the costs

for the project. In contrast, the Perot Systems contract was a noncompetitive award and provides for reimbursement of all approved costs.

We identified 13 other shared federal energy savings initiatives under consideration by several federal agencies, including the General Services Administration, and the Departments of Energy, Defense, and Housing and Urban Development. While these projects are in varying stages, none has yet been put under contract.

That concludes my statement. We will be pleased to respond to any questions.

STATEMENT OF POSTMASTER GENERAL ANTHONY M. FRANK
BEFORE THE SUBCOMMITTEES ON FEDERAL SERVICES, POST OFFICE,
AND CIVIL SERVICE AND ON OVERSIGHT OF GOVERNMENT MANAGEMENT
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

August 10, 1988

Messrs. Chairman:

We appreciate this opportunity to respond to your questions about the Perot Systems contract. We have viewed this contract as one small part of a very broad, comprehensive look at the Postal Service, to try to identify some innovative ideas and projects which will improve the postal system for the mailing public. We need the understanding and support of the Congress and the public for the changes that must be made so that this immense public service institution will keep up with the times and with your expectations.

I'd like, first, to put the Perot contract in perspective as I see it. Coming to this job from the private sector, I knew that I would find a very large, nationwide organization providing an important public service for the entire population of the United States. But I don't think anyone can fully appreciate the scale on which the Postal Service operates. More than 800,000 employees.....facilities in 40,000 locations.....100 million addresses served.....more than half a billion pieces of mail delivered per day. Numbers this large are for math exercises. They defy comprehension in human terms.

And they suggest more than how big the job is. They tell something about how heavily the Nation has come to depend on the

Postal Service, and how much is at stake in keeping our mail system equal to public needs and expectations.

For the Postal Service to maintain the good will it has built with the American people, we must be wise enough to find ways to satisfy changing needs and to make the postage dollar go farther.

We're determined to do exactly that. With the participation of many of our customers and the postal employee organizations, we are initiating a fresh look across a broad range of factors influencing cost and service. In my first meeting with postal managers, I urged them to take reasonable risks, to go for the best, in the belief that you can only be mediocre if you play it safe, and that's not good enough.

And I have tried to follow my own advice. I have challenged our organization to identify ten to twenty initiatives each worth $100 million to $200 million dollars in savings for the mailing public.

This is the general context in which we entered into the Perot Systems contract, as just one of many attempts to probe for new opportunities. The reputation of Ross Perot as a "can do" entrepreneur with a strong commitment to his country led the Governors to approach him about becoming Postmaster General well before they thought about asking Tony Frank. When I took the job I heard that he had expressed a willingness to help the Postal Service in some capacity. While I had never met Mr. Perot, I called him and we started talking.

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His expression of interest and willingness to play a part in our effort to look afresh at the way the Postal Service works struck me as a unique window of opportunity which potentially could be a great help to the postal system. His situation at the time happened to allow him to offer the benefit of an outside review for a three-month period, to see whether he and his people could come up with some novel proposals for improving some of the more challenging cost areas which we identified for him. Due to his individual contractual situation, the initial studies would be done on a cost basis, without profit, as would the initial months of any follow-on projects by which his company would implement proposals if the Postal Service made a decision to proceed.

The contractual arrangement with Perot Systems has been criticized as unusual and outside standard operating procedures. In a sense it was deliberately so. We were not looking for business as usual. We were looking for new approaches to some difficult challenges that have been with the Postal Service for a long time.

The initial term of the contract is short, providing in essence that Perot Systems Corporation will look at five designated areas of our operations for three months. If that look identifies opportunities to help us reduce our costs, they will submit proposals for further consideration and negotiation. If any of the proposals are accepted and do succeed in saving money, the firm would be paid for its efforts and results a yet

to be negotiated percentage of the savings starting in December, 1989.

Since performance under the first phase of the contract has been suspended due to litigation, no proposals have been submitted and the contractor's share for any individual project or the total amount which the contractor might receive has not been determined. The contractual arrangements for the negotiation of individual projects if the Postal Service elects to proceed with the contract's second phase maintain the control which we need to protect the public interest. I can assure you that our entire object in this arrangement has been to benefit the mailing public and that any proposals which we would accept would be negotiated with that target firmly in the forefront.

This is an innovative, and it follows, unusual contract for the Postal Service. We do not as a matter of policy frequently or casually enter into non-competitive contracts. I understand that in 1987 the Postal Service competitively awarded 96 percent of its procurement dollars, and this year should do about the same. That record of competitive procurement should stand up with anybody's. A good deal of caution is necessary to avoid mistakes and improprieties in huge government procurement systems, including ours. Protective rules and procedures, such as those followed by the Postal Service, are in the public interest.

But there are times when non-competitive awards make good business sense. All procurement systems, to be workable, must

make some provision for appropriate exceptions to the practices favoring competitive source selection, when circumstances warrant. Certainly the Postal Service needs the flexibility to try new and different methods on occasion to see if some useful progress can be achieved.

In my judgment, Ross Perot's availability for the fresh, outside look we desire warrants such an exception. His energy, expertise, and proven record, along with the unusual temporary situation which made the full attention of his company available to us at this time, appear to be a fortuitous match for our requirements. Within the postal community we have a great amount of creativity and expertise which we plan to harness in this effort as well. Ross Perot is willing to give us three months, at cost, to see whether he can propose some novel solutions to our problems, which we will have the chance to review and approve. I think the public will benefit from taking advantage of this opportunity.

The Postal Service is serious about improving its performance, about challenging the way it has operated in the past and making changes where appropriate. No doubt some mistakes will be made. We are counting on achieving important successes too. Without accepting some risks, the progress which I think the American people demand cannot be achieved.

For these reasons, even if you should decide that you disagree with me on the merits of the Perot contract, I urge you not to go along with any proposals to limit the contracting

flexibility of the Postal Service in general, or to subordinate our control over postal procurement to regulatory agencies within the Executive Branch. With the best of motives, other agencies cannot be expected to share the sense of urgency which drives the Postal Service to fulfill your assignment to us in the Postal Reorganization Act to get the mail delivered on time and to work to improve service and hold down costs for the public.

Through initiatives like the ones we have begun internally with the postal unions, and with a joint mailing industry-Postal Service worksharing project, we are working to provide to the American people the kind of postal system they expect and deserve to have, one that constantly searches for every opportunity to improve itself and to serve them better. It was in this spirit that we entered into the contract with Perot Systems.

I will be pleased to answer any questions you have.

STATEMENT BY POSTMASTER GENERAL ANTHONY M. FRANK
BEFORE THE SUBCOMMITTEES ON FEDERAL SERVICES, POST OFFICE
AND CIVIL SERVICE AND ON OVERSIGHT OF GOVERNMENT MANAGEMENT
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

August 10, 1988

Good morning. I appreciate the opportunity to be here. My written testimony was submitted to you earlier this week. I would appreciate its entry into the hearing record. At this time, I would like to go beyond that and provide you with a summary of my thinking about our contract with Perot Systems.

* * *

In March -- my first month as Postmaster General -- I attempted to harness the unique talents of Ross Perot and his new company to save money for the Postal Service, and -- in turn -- for the American people. For that, I have no apologies to make or regrets to express.

However ...

My zeal resulted in the negotiation of a contract perhaps more typical of the private sector than the government. This was clearly a mistake that I hope is not too late to rectify.

The results, so far, of the Perot contract have been:

o One, to cause this hearing.

o Two, to cause a suspension of the contract.

o Three, to cause a GAO report on the contract.

o Four, to cause an appeals court review of the GSBCA's jurisdiction over the contract.

o Five, to spotlight our possible inclusion under additional government procurement rules.

o Six, to consume a lot of time, energy and morale of Postal Service senior management.

Taking each of these in turn:

o One, this hearing -- I believe -- can result in a better contract between the Postal Service and Perot Systems without sacrificing the benefits.

o Two, I regret that the systems experts for Perot Systems have been idled by the suspension of the contract, but I believe it is still possible to resume the activities under Phase I by the end of next month.

o Three, I am appreciative of the GAO's efforts to conduct its study promptly. We are aware of its concerns and believe we can overcome them by modifying the contract.

o Four, I am pleased that the appeals court has accepted this matter for review and am confident that it will conclude that the independence granted us under the Postal Reorganization Act included removing us from the jurisdiction of the GSA.

o Five, I am sorry that this effort has put the spotlight on our possible inclusion under procedures which have never applied to the U.S. Postal Service. I believe that these rules should not apply, because they would undermine the authority granted to the postal Governors and management by the Postal Reorganization Act. As recently as May of this year, the GAO itself confirmed that authority, noting in a letter to Senator Pryor (and I quote):

"Congress has explicitly given USPS the authority, in the Postal Reorganization Act of 1970, to create its own procurement

rules and regulations, with the intent to permit USPS to operate like a private business when it is advantageous to do so. While USPS has only recently revised its procurement regulations to take advantage of its statutory authority to depart from the federal purchasing procedures and practices it inherited, there is no question that Congress has urged it to move in that direction. Further, there is widespread interest in experimenting with ways to improve the federal procurement system because of broad criticisms that current federal procurement practices are overly complex, cumbersome and restrictive."

o Finally, it is unfortunate to have others in the Postal Service pay for the education of a new Postmaster General in the area of government procurement.

* * *

Looking ahead now, we believe -- presuming the appellate court rules favorably, of course -- that it is possible to modify this contract substantially -- and to do so with the concurrence of Perot Systems. We have discussed a number of contract modifications that we believe to be responsive to the concerns that have arisen since we first announced our contract in June.

First, we will deal with concerns that the scope of this contract seems too unlimited. We propose to restructure the contract to allow Perot Systems to complete the Phase I studies and to supply support for the implementation of any projects identified. Perot Systems role would include assistance in

drafting RFPs and technical evaluations. Its role also would include integration and/or supervision as cost-saving ideas are competed or implemented. All assistance would be provided on a task basis and only if required by the Postal Service.

Second, we will assure fair competition for the implementation of cost-saving projects -- that is the Phase II activities under our original contract. These projects -- only if approved by the Postal Service -- would be done on a fully-competitive basis, and Perot Systems would not compete for this business.

Third, this contract will not result in obscene profits for Mr. Perot's firm. Perot Systems would work at cost until December 1989, and thereafter, would work under more traditional types of contracts determined by the type of work to be done. All of the contract provisions for these activities would be in accordance with our contracting regulations.

Fourth, under this arrangement, the Postal Service would retain the rights to all ideas.

Finally, the length of the contract would be adjusted. Perot Systems would receive a two-year contract with four, two-year options to renew at USPS discretion. In addition, our ability to cancel the contract for convenience will be extended to cover the full term of the contract.

It is clearly the responsibility of the Postal Service to pay as little as possible for the services and products we buy. It also is our responsibility to manage our costs as effectively as possible to protect the interests of the American mailers who

support us. We believe we can meet these responsibilities through our own efforts to improve postal operations and through a modified contract that satisfies the concerns of the Congress and our other constituencies, but which preserves the opportunity to bring Ross Perot and his people's unique expertise to bear on finding ways to make the Postal Service as efficient and cost-effective as is practical.

Thank you. That concludes my additional remarks. I will be happy to respond to your questions.

# # #

QUESTIONS SUBMITTED BY
SENATOR DAVID PRYOR

QUESTION 1. As you may know, we are currently in conference with the House on new Inspector General legislation. One of the issues before the conferees is whether to establish a more independent investigative arm within the Postal Service. It might be helpful to the conferees to have an understanding of how the Chief Inspector reacted to the Service's dealings on this Perot matter.

The Federal Services Subcommittee staff was briefed on August 4 by the Postal Inspection Service on its work relative to the Perot contract. Their work is apparently limited to what they call a developmental audit. According to the inspectors involved in this effort, they began their work in early June when they, along with the general public, first became aware of the contract. Now, according to internal documents we obtained, the Chief Postal Inspector was informed of negotiations with the Perot organization very early in the process--in March.

a. Did any management official direct the Chief Inspector not to disclose to others in the Inspection Service the existence of negotiations or not to undertake an independent audit investigation when he first learned of this activity, OR did the Chief Inspector decide on his own not to take any action?

ANSWER. At the request of the Postmaster General, the Chief Postal Inspector responded directly to the Subcommittees on this question. A copy of the Chief Postal Inspector's letter of September 9, 1988 is attached. (see attachment 1)

b. According to the documents mentioned above, Chief Inspector Clauson "had no negative reaction" to the briefing he received; and, apparently, unlike others who were briefed, he did not even submit any written views. Is this correct?

ANSWER. Please refer to the answer to "a" above.

QUESTION 2. The PMG has indicated on several occasions, for example, at the July 8 meeting of the Board of Governors, that the Perot contract has been controversial because it is unusual for government, but "not so unusual in the private sector." Can you supply examples of private sector contracts similar to the Perot contract?

ANSWER. The Postmaster General was indicating that some aspects of the Perot Systems contract which have been questioned by various parties would not be unusual in the private sector. Among these aspects are: the noncompetitive award, the absence of a termination for convenience provision for the entire term, and the absence of the standard Federal agency organizational conflict of interest provision.

QUESTION 3. We have heard a great deal about side-bar agreements to the actual contract. Please provide copies of each such agreement.

ANSWER. There was only one side-bar agreement between the parties to the contract. A copy of that agreement is attached. (see attachment 2)

QUESTION 4. In his statement discussing the proposed modifications to the Perot contract, the PMG stated that the involvement of Perot Systems in Phase II would be limited to "integration and/or supervision" and "assisting in drafting RFPs and technical evaluations." Can you explain, in detail, the extent of involvement envisioned under these terms--for example, would Perot Systems be given the responsibility for systems integration or be involved in actual technical evaluations?

ANSWER. The modifications envisioned would eliminate Phase II as defined in the original contract. In its place would be a task-ordering capability allowing the Postal Service, at its option, to obtain additional support services from Perot Systems on an as-required basis once the initial studies are completed.

The exact services to be acquired under task orders would be determined by Postal Service management on a case-by-case basis.

Perot Systems would not have overall responsibility for systems integration, but could be tasked by the Postal Service to provide planning and coordination support.

QUESTION 5. Documents addressed to Mike Coughlin (from Mr. Frank on March 8, 1988, and from Mr. Hunter on March 10, 1988) explore mechanisms for funding the then-anticipated contract with Ross Perot.

a. What information was developed pursuant to the March 8, 1988, inquiry relative to the A.D. Little contract?

ANSWER. Attached are two one-page sheets prepared by the Procurement and Supply Department and the Technology Resource Department, respectively. This is the only information developed pursuant to the March 8 inquiry relative to the A.D. Little contract. (see attachment 3)

b. The March 10, 1988, memorandum refers to the possibility of revising the estimated deficit as a means of covering the cost of any contract with Perot. Please explain scheme.

Also, provide all available information on the adjustment of estimated deficits that may have taken place during the last two years.

ANSWER. The March 10, 1988, memorandum from Mr. Hunter to Mr. Coughlin regarding revisions to the FY 1988 estimated net loss may have been misconstrued. When the Controller was contacted and asked if funds were available for this effort, a discussion of all the options took place between the Controller and a representative of Mr. Hunter's staff.

Included in the total FY 1988 budget of over $36 billion was a small amount for unexpected contingencies. In addition to this contingency amount, some latitude might also result if actual expenses were less than planned expenses. When the March 10, 1988 memorandum was written, it appeared that the May COLA due employees would be lower than planned for FY 1988 by $35 million. Another way to fund an unanticipated requirement would be to defer some other less important item until FY 1989. The continuing evaluation of actual vs. budgeted costs, coupled with a review and possible realignment of budget priorities, is a routine occurrence in any responsible organization. The statement that the Department of the Controller could arrange for the necessary funding simply reflected the Controller's judgment at that time that there was enough flexibility in the budget to accommodate a modest additional requirement without requiring a change to the bottom line. The Controller also pointed out that if the funds needed were substantial, the Postmaster General could approve an adjustment that would affect the official planned FY 1988 net loss for the Postal Service. The Controller used the Omnibus Budget Reconciliation Act as an example of this option. The Act increased USPS expenses by $510 million and resulted in an increase to the budgeted FY 1988 net loss of $350 million.

The Postal Service's current year operating budget is not changed other than for significant extraordinary events. During the past three years, the only change to the approved current year budgeted net income or loss has been to reflect the impact of the Omnibus Budget Reconciliation Act of 1987. Outyear forecasts and year-end projections, which are not approved budgets, are periodically revised to reflect changing trends and assumptions for planning purposes, but not to provide funding for specific projects.

CHIEF POSTAL INSPECTOR
Washington, DC 20260-2100

September 9, 1988

Honorable David Pryor
United States Senate
Washington, DC 20510

Dear Senator Pryor:

I have been asked by the Postmaster General to respond directly to your question number 1 submitted for the record at the August 10 appearance of the Postmaster General before the Senate Government Affairs Subcommittee on Federal Services, Post Office, and Civil Service and Oversight of Government Management. For ease of reference, your question was as follows:

"1. As you may know, we are currently in conference with the House on new Inspector General legislation. One of the issues before the conferees is whether to establish a more independent investigative arm within the Postal Service. It might be helpful to the conferees to have an understanding of how the Chief Inspector reacted to the Service's dealings on this Perot matter.

The Federal Services Subcommittee staff was briefed on August 4 by the Postal Inspection Service on its work relative to the Perot contract. Their work is apparently limited to what they call a developmental audit. According to the Inspectors involved in this effort, they began their work in early June when they, along with the general public, first became aware of the contract. Now, according to internal documents we obtained, the Chief Postal Inspector was informed of negotiations with the Perot organization very early in the process -- in March.

a. Did any management official direct the Chief Inspector not to disclose to others in the Inspection Service the existence of negotiations or not to undertake an independent audit investigation when he first learned of this activity, OR did the Chief Inspector decide on his own not to take any action?

b. According to the documents mentioned above, Chief Inspector Clauson "had no negative reaction" to the briefing he received; and, apparently, unlike others who were briefed, he did not even submit any written views. Is this correct?"

Before responding to questions referenced a. and b., I would like to offer the following observation regarding independence from the business decision-making process.

Independence is the second general standard for government auditing as outlined in Government Auditing Standards issued by the Comptroller General of the United States, standards which the Inspection Service adheres to in carrying out our audit work. That document recognizes the need for audit entities to remain independent of the decisionmaking and management function as it relates to operations and programs. Clearly, an individual involved in the management decision process cannot be expected to conduct an independent and objective audit or investigation of that same decision.

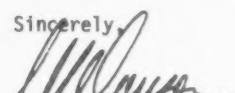
As a senior official of the Postal Service, I was aware of negotiations with the Perot organization very early in the process. I was not a party to that negotiation nor should I have been. No one in management or elsewhere directed me not to disclose to others in the Inspection Service the existence of the negotiations. In fact I discussed the negotiations with members of my staff and others. No one in management suggested or ordered that I not undertake independent audit or investigation of this or any other activity of the Postal Service. Had I felt audit or investigative attention was necessary, I would not have hesitated to initiate it. I did discuss the concept of the Perot project with the Postmaster General and others. I told them I saw no criminal violation in the concept. I did not provide written comments.

Inspection Service work was not limited to developmental audit attention in this case. Shortly after the Perot contract was let, we did an analysis of the contract. During that review, concerns were raised regarding some aspects of the contract. In addressing those concerns, we felt developmental audit attention would be the best approach to ensure Postal Service interests were protected.

Developmental audits provide one of the most effective means to learn and understand program design, direction and implementation. Developmental audit work is designed to ensure that audit trails and security features are built into new programs and also allows Inspectors to keep their "thumb on the pulse" of what's happening. It was developmental audit work which led to our successful investigation of the Voss case.

Our developmental audit work has been put on hold pending outcome of the several actions relating to the contract. If I can be of further assistance, please do not hesitate to call.

Sincerely,



C. R. Clauson

QUESTIONS SUBMITTED BY SENATOR SASSER

QUESTION. According to the G.A.O. Report, it is the position of the Postal Service that Perot System's five-year "exclusive right" to ideas extends only to those projects "approved" by the Postal Service. Yet I understand that under the modified "termination for convenience" clause, if the contract is canceled any time after the 90-day study period--which could take place before any or all of Perot's suggestions are approved--his company is nevertheless guaranteed 50% of the savings that "would have been realized" over the 10-year contract period. Now, that sounds inconsistent to me--under contract, Perot's profit is contingent on Postal Service approval, but he's better off if he's canceled because he has a guarantee on hypothetical savings. Can you clarify this for us?

ANSWER. In the August 10 Joint Senate Hearings, the Postal Service proposed to restructure the Perot Systems contract in response to concerns which have been raised about the contract. Based on tentative discussions with Perot Systems, the provision in question would not be applicable if the Postal Service elects to proceed with a modified Perot Systems contract.

Under the original contract Perot Systems would have been guaranteed 50 percent of its share of the savings if the Postal Service terminated for convenience at any time after two years of the effective date of the contract not at "any time after the 90-day study period." This share would have been based on the actual savings realized by the U.S. Postal Service prior to termination and the share of savings which Perot Systems would have received based on negotiations to be held after receipt of the study proposal. Agreement on a cost savings share formula would have been required prior to proceeding with the implementation phase. The contract did not guarantee Perot Systems 50 percent of the total savings to be realized. Perot Systems (in the event of a termination for convenience) was guaranteed 50 percent of what otherwise would have been its share, not 50 percent of total savings.

QUESTION. What about the possibility that some of the "ideas" Perot Systems might come up with will resemble or reflect proposals that have been the subject of past study by the Postal Service itself? For instance, we are aware of automated processing improvements that are "in the works" at the Postal Service but at the present time, are still a few years down the road. Do you feel that the contract with Perot Systems takes adequate account of the pre-existing nature of some ideas? And

how do you foresee resolving any dispute between the Postal Service and Perot--for example, if you don't approve one of his proposals, but implement something similar on the grounds that it was a Postal Service idea to begin with?

ANSWER. Under the restructured contract suggested during the hearings, the Postal Service would own all rights to the ideas developed by Perot Systems. There is tentative agreement with Perot Systems on this issue.

The contract as originally written contemplated that the Postal Service would retain its rights to previous Postal Service ideas or proposals. The Postal Service was monitoring contract study activity closely, and is aware of specific studies, proposals, and ideas generated by or for the Postal Service which may be used by Perot Systems in its proposed implementation projects. The contract also provided that the Perot Systems savings share would be based in part "...on the extent of each party's contribution to the proposed solution".

In addition, shortly after contract award the Postal Service and Perot Systems became aware of the many differing interpretations that various parties were making of the contract's provisions regarding the ownership of the ideas. Perot Systems and the Postal Service agreed that all ideas belonged to the Postal Service, but that the Postal Service could not implement approved projects with anyone other than Perot Systems for a 5-year period. The contract was never modified to reflect this and other clarifying agreements due to the intervention of the General Services Board of Contract Appeals.

QUESTION. It's been suggested that Mr. Perot's energy, expertise and flair for innovation can still be put to use during the first phase of the project. And then, if the same expertise and management ability are reflected in his specific proposals for implementation, he should take his chances in a competitive phase 2 of the project and ought to come out fairly well. Can you comment on this or any of the other alternatives that have been put forth for going forward on this contract? Specifically, has the Postal Service considered modifying those aspects of the contract that have given rise to the most concern--such as, for example, placing some ceiling on the reimbursable costs or profits of Perot Systems under Phase 2?

ANSWER. The Postal Service has reached tentative agreement with Perot Systems on a restructured contract as indicated by the Postmaster General in the August 10 hearing. Although no decision has been reached yet about continuing a contract with Perot Systems, the tentative restructured contract would have Perot Systems completing the study phase and providing implementation

support to the Postal Service on an "as elected by the Postal Service" basis. Perot Systems would not implement any of the projects coming from the study phase nor be allowed to compete for the opportunity to implement those projects. Any arrangement which may be concluded will have to take account of the October 20 order of the Circuit Court of Fairfax County Court.

Perot Systems would provide implementation support services as directed by the Postal Service through the issuance of task orders under a cost-plus-award-fee (CPAF) arrangement. The fee payable under this CPAF arrangement would fall between a base of four and a maximum of fifteen percent.

The proposed restructuring does not allow for Perot Systems to compete for implementation projects because we believe that opponents of the Postal Service contract with Perot Systems would assert that Perot Systems would have an unfair competitive advantage in Phase 2.

QUESTION. Your Assistant Postmaster General, Mr. Davin, in approving the Perot contract as a non-competitive award, noted that a "full business review" would be made of any Perot Systems proposal before it proceeded beyond the study phase. I wonder if you could clarify for us what team at the Postal Service will be responsible for this review; what criteria you expect to consider, since there is a "mutual expectation" that reasonable ideas will be approved; and whether the review process will be open to public discussion and comment?

ANSWER. The proposed contractual restructuring announced in the August 10 hearing would not provide for Perot Systems proceeding to actual implementation of its proposals.

The business review contemplated by Mr. Davin would have been conducted by the Contracting Officer, the Acting Assistant Postmaster General, Technology Resource Management (the lead technical program manager), and the technical program manager designated for each study area. Management review, including that of Mr. Davin, would be obtained at a level commensurate with the scope of the proposed project. In addition, the Postal Inspection Service would assign a developmental auditor to monitor the process.

The criteria for the review would be the best interest of the Postal Service. Elements to be considered would include the services to be performed, the implementation plan and schedule, the opportunity for cost savings, the cost for project implementation, and Perot Systems compensation proposal. The contract provided that projects would be approved unless the Postal Service determined that implementation would be contrary to

the business objectives and policies of the Postal Service. We believe that the contract provided the Postal Service the discretion to conduct the kind of business review contemplated by Mr. Davin and make a decision regarding approval of any implementation projects accordingly. We will also ensure that any restructuring of the Perot Systems contract will provide for appropriate Postal Service review of contractor effort.

The Postal Service has committed to keep Congress fully informed on events regarding the contract.

QUESTIONS SUBMITTED BY
SENATOR CARL LEVIN

QUESTION 1. You testified before the Subcommittees that the Postal Service would attempt to obtain the written agreement of Perot Systems to the suspension of the 90-day study period in the contract and that if such agreement was not forthcoming, the Postal Service would exercise its right, under the side-bar agreement with Perot Systems, to terminate the contract.

a. Has the Postal Service obtained the written agreement of Perot Systems to the suspension of the 90-day study period in the contract?

ANSWER. Yes. However, the Postal Service did not need to obtain the written agreement of Perot Systems to the suspension of the 90-day study period. The Postal Service had the unilateral right under the contract to suspend performance. We believe this question is actually referring to the status of the Postal Service's right to terminate the contract during the study period. Perot Systems has agreed that the clock has stopped on the termination right with the suspension of the contract.

b. If so, please provide a copy of this written agreement.

ANSWER. Attached is a copy of a letter showing Perot Systems' understanding of the current status of the Postal Service's right to terminate the contract during the study period. (see attachment 4)

c. If not, has the Postal Service exercised its right, under the side-bar agreement, to terminate the contract?

ANSWER. Please refer to "a" above.

QUESTION 2. By letter dated August 12, 1988, you acknowledged that the Postal Service had not produced all documents responsive to the Subcommittees' July 28, 1988 request.

a. In accordance with the July 28 request, please provide a copy of "all documents" relating to the negotiation and award of the Perot Systems contract.

ANSWER. The additional material requested was delivered to the Subcommittees with a copy to Senator Pryor's office on Monday, August 22, 1988.

b. Please describe the steps that have been taken to ensure that the Postal Service's document review is complete and that all documents requested have been produced.

ANSWER. Following receipt of the July 28 request, organizations at Postal Headquarters were asked to review all files and produce the documents necessary to respond to the Subcommittees. This review included relevant files contained within the Law Department, the Procurement and Supply Department, the Government Relations Department and the Finance and Planning Group. In addition, senior postal managers were requested to review their personal files and provide all such documents. All of this material was collected, copied and transmitted to the Subcommittees by letter of August 8. It should be noted that, as stated in the question, the July 28 request was for information relating to the "negotiation and award of the Perot Systems contract." This was construed as a request for certain specific information which differed from that requested by Senator Grassley on July 21 in his letter to the General Accounting Office. Upon learning that some desired documents were not included in the August 8 package sent to the Subcommittees, a further review of files was conducted. This additional material was delivered to the Subcommittees on August 22. With the transmittal of the additional material we believe that all documents requested by the Subcommittees have been produced.

QUESTION 3. Section 3.2.1 of the new Postal Service Procurement Manual Procurement Manual states: "Since the purpose of publicizing is to promote competition, publicizing non-competitive purchases . . . would serve no Postal Service purpose."

This policy is directly contrary to the policy established by the Competition in Contracting Act (CICA) for all other federal agencies. CICA expressly requires federal agencies to publicize all prospective contracts, including sole-source contracts. With regard to sole-source contracts, an agency is required to publish the justification for going sole-source and the identification of the intended source in the Commerce Business Daily at least 30 days before the award of the contract. This provision was intended to prevent federal agencies from focusing exclusively on a single potential source and making non-competitive contracting a "self-justifying and self-fulfilling prophecy" -- as the General Services Board of Contract Appeals found the Postal Service did in this case.

a. What is the basis for the Postal Service's determination that the principle of disclosure of sole-source contracts, established by Congress for all other federal agencies, "would serve no Postal Service purpose"?

ANSWER. The intent of Section 3.2.1 was to indicate that if the Postal Service had arrived at a valid determination that a noncompetitive contract was necessary and justified, subsequent publicizing would not provide any immediate benefit to the Postal Service. Section 3.2.1 does not prohibit publication when there is a question regarding the possibility of competition. In fact,

the Postal Service often publishes "sources sought" notices in the Commerce Business Daily (CBD) prior to approval of a noncompetitive purchase request. In this instance the Postal Service was convinced that Mr. Perot and Perot Systems represented a unique opportunity, and that subsequent CBD publicizing was not appropriate.

b. In light of the policies underlying the Competition in Contracting Act and the problems with the secret negotiations of this contract, does the Postal Service intend to reexamine the rule which exempts it from disclosure of non-competitive contracts?

ANSWER. We do not believe that it is accurate to characterize the negotiations with Perot Systems as "secret." The Postmaster General had indicated as early as May 4 in testimony before the House Post Office Subcommittees' annual oversight hearing on the Postal Service that discussions were underway with Mr. Perot. In addition, there were a number of press reports regarding these discussions before execution of the contract. We will, however, re-examine Section 3.2.1 of the Procurement Manual.

We also think it is important to note that despite not being covered by the Competition in Contracting Act and other legislation which focuses on the concept of competition, the Postal Service record on competition compares very favorably with those of other agencies. For example, in Fiscal Year 1987, 92.9 percent of Postal Service contractual actions were awarded competitively as was 96.3 percent of the dollar amount awarded.

QUESTIONS SUBMITTED BY
SENATOR CHARLES GRASSLEY

During the August 10th hearing, the Postal Service testified that Perot Systems is singularly qualified to perform the analysis and services for the most benefit to the Postal Service. It has been further argued that the unique benefits available to USPS through Perot Systems warrant a highly unique contract.

Documents provided me as a result of a request to the General Accounting Office, however, raise significant questions regarding the extent to which the Postal Service was confident of Mr. Perot's singular qualifications for this task.

QUESTION 1. Notes between Mr. Hunter and Postmaster Frank during the week of 3-21 indicate that negotiations were occurring on the contract before Perot even had a company. Notes dated May 6th from a teleconference requested documentation of qualifications of the staff in order to provide justification for the sole source contract. Yet the resumes were not provided until June 1st, only one day before the contract was announced.

a. How did the Postal Service know that Ross Perot's firm was uniquely qualified to perform the contract before his company was formed and before the qualifications of the personnel were identified?

ANSWER. The Postal Service based its determination on the proven capability of Mr. Perot to attract singularly qualified people and on his commitment to do so. The Postal Service had the ability to terminate the contract had Mr. Perot failed to provide the staff as promised. We believe the record indicates that he did provide highly qualified staff for this contract.

b. These same notes spell out that of primary interest to Perot was $500-600 million. Is this figure the sum of money that Perot expected to receive from the Postal Service contract? If not, what does it refer to? If so, what was the premise on which this sum was calculated? How could the revenue or savings be calculated before the terms of the projects were established? Had the Postal Service conducted and analysis to determine if there was an alternative that would have been less costly?

ANSWER. The $500-600 million figure was a recounting of Mr. Perot's remarks describing the scale of the areas in which he would be interested in involving himself. He had indicated in meetings with postal managers that his interests were in addressing large, significant aspects of the Postal Service on a multi-year basis, and had used the $500-600 million figure to indicate the size which would interest him.

There was no precise meaning associated with the figure. It was simply an attempt to describe an order of magnitude for the areas which would be of interest to Mr. Perot, at a time when discussions were very preliminary and tentative.

QUESTION 2. Postmaster General Frank has repeatedly referred to the benefits of being the only, or at least the initial and principle, client of a firm. A March 10th memo on the A.D. Little contract states that "In pursuance of that contract, Arthur D. Little has established a separate facility in Washington, D.C., called the Technology Resource Center. Its efforts are fully dedicated to the Postal Service." According to the documents, however, the U.S. Postal Service was attempting to justify termination of that contract, or at least explored termination of that contract, in order to pursue a contract with Perot.

a. What is the present status of the A.D. Little contract?

ANSWER. The A.D. Little contract is an active contract which extends through April 15, 1991.

b. If it has been terminated, was that to accommodate the Perot contract?

ANSWER. The A. D. Little contract has not been terminated.

c. What is the justification for terminating a contract with a firm "fully dedicated" to serving the USPS and which has an excellent record in that performance, in order to pursue a contract with another firm which was just getting off the ground and would be soliciting other business?

ANSWER. Please refer to answers to "a" and "b" above.

QUESTION 3. Members of Congress have questioned the conflict of interest that exists when the same firm which conducts analysis and needs assessment also implements the ensuing plans and recommendations. USPS documents provided me through the GAO indicate that officials in the Postal Service shared those concerns while the contract terms were being developed. An internal memo dated May 13, for example, (to Ken from Keith) discusses problems with conflict of interest. Repeated discussions in the Postal Service, evidenced through additional memos and notes, raised questions of handling legal and ethical hurdles, as well as concerns about perceptions. Notes from the May 6th teleconference requested inclusion of standard termination for convenience provisions, in order to provide an "out" in case of political pressure.

a. Were these officials in the Postal Service satisfied that the questions of conflict of interest, as well as ethical and legal hurdles, were resolved?

ANSWER. All Postal Service officials who were involved in the approval of the contract agreed to proceed with the initial study phase. There was recognition that the contract posed some risks but it was believed that those risks were manageable in consideration of the expected benefits of Perot Systems efforts.

b. How were these questions resolved?

ANSWER. The conflict of interest question was resolved by examining the intent of the organizational conflict of interest provision which is clearly aimed at a situation where a firm conducts analysis and needs assessment and then competes for the right to implement the ensuing plans and recommendations. The provision is intended to prevent an unfair competitive advantage. The original design of this contract contemplated that Perot Systems would do a needs assessment, propose an implementation project and, if agreed by the Postal Service, proceed with implementation. Competition between Perot Systems and other firms on implementation projects was not the original intent. This approach was believed to be the most effective and quickest way to achieve the savings the Postal Service was seeking.

We believe the contract file, which has been previously furnished, clearly indicates the Postal Service position on the legal issues raised during discussions and that those questions were satisfactorily resolved.

c. What was the benefit in proceeding with the contract despite ethical and legal questions that were sure to emerge again from Congress and other interested firms?

ANSWER. The Postal Service was aware that the contract would receive a great deal of scrutiny. We welcomed that scrutiny in the knowledge that the contract was not typical and, in fact, went to extra lengths to make copies of the contract available to congressional staffs, the press, and other interested parties. We believed that the risks posed by the contract terms could be managed and that the potential benefits were great.

QUESTION 4. An internal memo, dated March 28th, to Charters and Hunter from Horgan refers to "relationship with PMG." It also refers to "implication of 'sweetheart' deal" and "appearance of USPS predisposition."

a. What was that relationship between Mr. Perot and Mr. Frank, that was evident as early as March?

ANSWER. As Mr. Frank has stated publicly, he had no business or social relationship with Mr. Perot prior to accepting the position of Postmaster General; in fact, the two had never met. In February 1988 following his selection by the Governors as Postmaster General and upon learning that Mr. Perot had expressed a willingness to help the Postal Service in some capacity, Mr. Frank called Mr. Perot. That conversation and discussions in subsequent meetings between the parties centered on Mr. Frank's desire to have a fresh look taken at the way the Postal Service works, Mr. Perot's willingness and capability to assist in that effort and Mr Perot's availability.

b. What was PMG connection to Ross Perot, referred to in the documents as one of the advantages associated with this contract?

ANSWER. The only discovered use of the phrase "PMG connection" (to Ross Perot) is contained in the above referenced March 28 memorandum and appears under the heading of possible "cons" (disadvantages) of a decision by postal management to enter into a contractual relationship with Perot Systems. If the phrase is used to indicate an advantage to the Postal Service of such a relationship elsewhere in the voluminous material transmitted to the subcommittees, we believe that its use reflects the opinion of the author of that document that any subsequent business arrangement between the Postmaster General and a proven achiever such as Mr. Perot would be viewed as positive.

QUESTION 5. Although Senator Levin has received a response from the Postal Service regarding the differences in the set of documents delivered to him, there remain some pertinent questions about those differences:

Senator Pryor and Levin, in a letter to the Postmaster General dated July 28, 1988, specifically requested documents relating to the March 7, 1988, meeting between Mr. Perot and the Postal Service Board of Governors. The letter in response, dated August 8, 1988, stated that there are no documents relating to that meeting. However, documents delivered to myself included a memo from David F. Harris to Mr. Frank, dated March 8, 1988, referring to the meeting held on the previous day. The memo referred to Mr. Perot as "impressive!" A memo from K.J. Hunter for the senior management committee, dated 4-20-88, also referred to March 7th meeting.

Please explain this discrepancy.

ANSWER. As the Postmaster General stated in his testimony before the Subcommittees, the intent of the Postal Service was to provide the Subcommittees with all the information requested. However, as different organizations within Postal Headquarters responded to different requests from the Congress and the General Accounting

Office, some material was omitted from the packages sent to Senators Pryor and Levin, perhaps through inadvertence or perhaps because "relating to the March 7 meeting" was not understood as intended to encompass papers that merely referred to that meeting in passing but did not include anything of substance in regard to it. With the additional information transmitted by the Postal Service on August 22, we believe the Senators and the Subcommittees have all documentation relevant to the Perot Systems contract.

QUESTION 6. What is the justification for maintaining a high level of involvement from Perot Systems, Inc., in the second phase of the contract? What is the justification for not competing the support, integration and evaluation role that is to be given to Perot Systems under the modified contract?

ANSWER. We believe that Perot Systems still offers a unique capability in the effort to identify and achieve significant cost savings. The Postmaster General has agreed to attempt to modify the contract so that other firms would have the opportunity to compete to assist the Postal Service in implementation of the projects developed by Perot Systems. Further, Perot Systems would not be able to compete for the implementation projects because other companies would assert that Perot Systems would have a competitive advantage. As Perot Systems would have conceived and designed the projects during the study phase, we believe it is uniquely qualified to assist the Postal Service in achieving effective implementation. Otherwise, the singular capability that Perot Systems represents will be lost by the Postal Service for all but the study phase.

QUESTION 7. As you know, the 90 day time period referenced in the side bar agreement in the original Perot contract would expire on September 4th. As this date is soon approaching, it is vitally important that the Postal Service obtain written agreement from Perot Systems which clearly states that the period of time within which the Postal Service could terminate the contract without liability has been suspended. I would like a copy of this written agreement as soon as possible; I will expect to receive that document within one week of the date of this letter.

ANSWER. A copy of the document requested was delivered to your Senate office on Tuesday, August 30, 1988. An additional copy is attached. (see attachment 4)

QUESTION 8. During my testimony at the August 10th hearing, I referenced a document in which officials at the Postal Service suggested that USPS deficit projections could be altered in order to "free up" funding for the Perot contract.

a. Was the deficit projection altered in any way since March of this year? If yes, please provide me with the deficit estimates before and after the alteration.

ANSWER. The official U.S. Postal Service planned net income or loss as reflected by the approved FY 1988 budget was not adjusted. However, a mid-year deficit projection of $472 million for FY 1988 was developed during March and shared with the Board of Governors at the April meeting. The mid-session review with OMB during June 1988 reflected a net loss of $430 million. Both estimates were based on a higher revenue forecast than included in the FY 1988 operating budget. It is important to note that "deficit projections" are not changes to approved budgets.

b. If yes, were the "savings" from the deficit adjustments applied to the Perot contract?

ANSWER. No

c. Please provide a summary of every instance in which the Postal Service adjusts its deficit projections presented to Congress to fund a desired project.

ANSWER. The Postal Service does not adjust its deficit projections to provide funding for specific projects. The Postal Service's current year planned net income or loss is not changed once approved for other than significant extraordinary events. The only change to the approved current year budgeted net income or loss over the past three years has been to reflect the impact of the Omnibus Budget Reconciliation Act of 1987.

SUMMARY COMMENT:

An April 20th memo from K.J. Hunter to the senior management committee reflects an interest in working out a plan that would be mutually beneficial to the Postal Service and Mr. Perot. This memo points to a process seeking mutual benefit to the parties, rather than the development of a plan and solicitation of a vendor to implement it. The final paragraph in the memo reflects concerns about legal and ethical risks and the need to "guard against undue adverse reactions among concerned parties."

Apparently officials at the Postal Service had concerns that have been expressed by Congress.

I repeat my contention, as expressed in my testimony on August 10, that the Postal Service should terminate the Perot contract and start with a clean slate. I encourage the Postal Service to take the advice of Mr. Mulligan, stated in a March 28th memo to Mr. Hunter: "Instead of seeking opportunities compatible with the capabilities of a particular firm or individual, we should be focusing first on identifying those opportunities of high priority and high value to the Postal Service, and then seek the best solution for exploiting those opportunities."

ATTACHMENT 1

CHIEF POSTAL INSPECTOR
Washington, DC 20260-2100

September 9, 1988

Honorable David Pryor
United States Senate
Washington, DC 20510

Dear Senator Pryor:

I have been asked by the Postmaster General to respond directly to your question number 1 submitted for the record at the August 10 appearance of the Postmaster General before the Senate Government Affairs Subcommittee on Federal Services, Post Office, and Civil Service and Oversight of Government Management. For ease of reference, your question was as follows:

"1. As you may know, we are currently in conference with the House on new Inspector General legislation. One of the issues before the conferees is whether to establish a more independent investigative arm within the Postal Service. It might be helpful to the conferees to have an understanding of how the Chief Inspector reacted to the Service's dealings on this Perot matter.

The Federal Services Subcommittee staff was briefed on August 4 by the Postal Inspection Service on its work relative to the Perot contract. Their work is apparently limited to what they call a developmental audit. According to the Inspectors involved in this effort, they began their work in early June when they, along with the general public, first became aware of the contract. Now, according to internal documents we obtained, the Chief Postal Inspector was informed of negotiations with the Perot organization very early in the process -- in March.

a. Did any management official direct the Chief Inspector not to disclose to others in the Inspection Service the existence of negotiations or not to undertake an independent audit investigation when he first learned of this activity, OR did the Chief Inspector decide on his own not to take any action?

b. According to the documents mentioned above, Chief Inspector Clauson "had no negative reaction" to the briefing he received; and, apparently, unlike others who were briefed, he did not even submit any written views. Is this correct?"

Before responding to questions referenced a. and b., I would like to offer the following observation regarding independence from the business decision-making process.

Independence is the second general standard for government auditing as outlined in Government Auditing Standards issued by the Comptroller General of the United States, standards which the Inspection Service adheres to in carrying out our audit work. That document recognizes the need for audit entities to remain independent of the decisionmaking and management function as it relates to operations and programs. Clearly, an individual involved in the management decision process cannot be expected to conduct an independent and objective audit or investigation of that same decision.

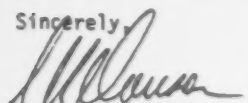
As a senior official of the Postal Service, I was aware of negotiations with the Perot organization very early in the process. I was not a party to that negotiation nor should I have been. No one in management or elsewhere directed me not to disclose to others in the Inspection Service the existence of the negotiations. In fact I discussed the negotiations with members of my staff and others. No one in management suggested or ordered that I not undertake independent audit or investigation of this or any other activity of the Postal Service. Had I felt audit or investigative attention was necessary, I would not have hesitated to initiate it. I did discuss the concept of the Perot project with the Postmaster General and others. I told them I saw no criminal violation in the concept. I did not provide written comments.

Inspection Service work was not limited to developmental audit attention in this case. Shortly after the Perot contract was let, we did an analysis of the contract. During that review, concerns were raised regarding some aspects of the contract. In addressing those concerns, we felt developmental audit attention would be the best approach to ensure Postal Service interests were protected.

Developmental audits provide one of the most effective means to learn and understand program design, direction and implementation. Developmental audit work is designed to ensure that audit trails and security features are built into new programs and also allows Inspectors to keep their "thumb on the pulse" of what's happening. It was developmental audit work which led to our successful investigation of the Voss case.

Our developmental audit work has been put on hold pending outcome of the several actions relating to the contract. If I can be of further assistance, please do not hesitate to call.

Sincerely,



G. R. Clauson

ATTACHMENT 2

PEROT SYSTEMS CORPORATION
12377 Merit Drive
Dallas, Texas 75251

May 27, 1988

Mr. Anthony M. Frank
The Postmaster General
United States Postal
Service
475 L'Enfant Plaza W, S.W.
Washington, DC 20260

Re: Contract, dated May 26, 1988, between the United States Postal Service and Perot Systems Corporation

Dear Tony:

This letter confirms that I will agree to terminate the above-referenced contract during the initial ninety (90) day study period if you determine that continuation of the contract is not in the best interests of the United States Postal Service and so request in writing.

In the event of such a termination, Perot Systems Corporation would remain entitled to payment of all amounts payable pursuant to the contract for services rendered prior to the date of termination.

Sincerely,

Ross Perot

ATTACHMENT 3

USPS CONTRACT WITH A.D. LITTLE

DESCRIPTION OF CURRENT CONTRACT

- Signed April 15, 1983.
  Three-year term with five one-year options.
  Entire option period has been exercised.
  Contract runs thru April 15, 1991.

- Contract type-cost reimbursement plus award fee.
  Performance evaluated semi-annually.

- Over five years to date, expenditures have averaged just under $600,000 per month--also current rate.

- Billings based on costs incurred in performance of approved project task orders.

- $68,370,000 Board of Governors approved contract ceiling.
  $36,000,000 spent to date.

METHOD OF CONTRACTING

- Competitive procurement late 1982 to early 1983.
  Contract out systems engineerinng and technology development.
  Seven proposals received and evaluated.
  Finalists included SRI, ADL, and Booz-Allen.

- Primary evaluation emphasis placed on understanding, company experience, calibre of people, and proposed approach.

- Contracting approach is to enter into project task orders for selected and approved subject areas.

OPTIONS AND FLEXIBILITY

- Only total option is termination for convenience.
  Task level can always be adjusted.

- Can terminate at any time.
  Must pay all incurred costs plus settlement costs.
  Current estimate to do so is approximately $1 million.

- Ordinarily such action implies completion or elimination of requirement.

- If we recontracted for similar services this could lead to litigation.

- The contract is not transferable.

Procurement and Supply Department

ARTHUR D. LITTLE SUPPORT

In April 1983, the Postal Service entered into a contract with Arthur D. Little of Cambridge, MA. In pursuance of that contract, Arthur D. Little has established a separate facility in Washington, DC, called the Technology Resource Center (TRC). Its efforts are fully dedicated to the Postal Service. They employ 50 professionals, plus support staff. More than 20 percent have Ph.D's. in operations research, mathematics, physics, engineering, etc. About 60 percent have other advanced degrees in the above disciplines. Their performance over the past five years has been excellent.

They work on a task order basis with each individual task approved by the Postal Service. Among the tasks they are currently working on are:

1. Automatic Postal Teller. An automatic, interactive vending system for retail customers, as well as an interactive information kiosk. The equipment uses modern technology, including multicolored touch screens, video disks, and CD-ROMs. The equipment will be field tested late this year. It is similar in concept to ATMs.

2. National ZIP + 4 Directory. A patented process, owned by the Postal Service, which allows us to store a complete national directory in a very small memory and retrieve the address at a very high rate. The technical information was disclosed to industry last month and will be made available free of charge to suppliers of postal equipment. In addition, Arthur D. Little will attempt to sell the technology for a shared license fee to non-postal suppliers.

3. System Tradeoff Model. The System Tradeoff Model is a simulation of the postal network running on a PC. It allows top management to ask many "what if" questions and allows them to make decisions on deployment of automation equipment and the rerouting of transportation media.

4. Materials Handling. The TRC is providing support to the major materials handling project at the Engineering Support Center.

5. General Support. The TRC is a major source of support to the Technology Resource Department (TRD) in furtherance of the concept that we would keep the TRD small (17 employees) and utilize contract support to the maximum where and as needed.

In addition, Arthur D. Little has assisted the retail department in developing the strategies for stamp consignment, stamp by mail, stamp by phone, and other retail initiatives/strategies. The TRC also played a major role in the systems analysis of solutions to the "carrier-in-office" challenges leading to the current Advanced Distribution Systems project. Arthur D. Little also assists the Office of Automation Integration.

Technology Resource Department

ATTACHMENT 4

P.S.

PEROT SYSTEMS
1595 Spring Hill Road
Suite 777
Vienna, VA 22180-2228
(703) 847-8800

August 16, 1988

Mr. A. Keith Strange
Director, Office of Procurement
Room 1011
United States Postal Service
475 L'Enfant Plaza W, SW
Washington, DC 20260-6230

Dear Keith:

The purpose of this letter is to confirm Perot Systems' understanding of the status of the study phase of the contract and the right of termination on notice conferred on the Postal Service by Ross Perot's letter of May 27.

Perot Systems understands that the contract was suspended on July 8, 1988, at the close of business. We also understand that under the current contract fifty-seven days remain in the ninety day study period and that any time during this study phase the Postal Service has the right to terminate as expressed in the May 27, 1988 letter.

We anxiously await the final decision of the Court and the ability to resume work under the restructured contract.

Sincerely,

J. Patrick Horner

135 Hart Senate Office Building
Washington, DC 20510
(202) 224-3744

721 Federal Building
210 Walnut Street
Des Moines, IA 50309
(515) 284-4890

206 Federal Building
101 1st Street S.E.
Cedar Rapids, IA 52401
(319) 365-2558

United States Senate

CHARLES E. GRASSLEY

103 Federal Courthouse Building
320 6th Street
Sioux City, IA 51101
(712) 233-3331

210 Waterloo Building
531 Commercial Street
Waterloo, IA 50701
(319) 232-6657

116 Federal Building
131 E. 4th Street
Davenport, IA 52801
(319) 322-4331

October 11, 1988

Mr. Anthony M. Frank
The Postmaster General
United States Postal Service
475 L'Enfant Plaza W., S.W.
Washington, D.C. 20260

Dear Mr. Frank:

I am writing to express my general dissatisfaction with the Postal Service's responses to written questions following your Senate testimony on the USPS/Perot Systems contract. These responses fail to provide adequate justification for the initial sole source award to Perot Systems, or any future sole-sourced role for the company. Furthermore, the responses did not provide any additional description of the potential contract modifications mentioned briefly in your testimony.

It is also unclear from these responses and from recent public comments by USPS representatives what action, if any, will be taken on the Perot Systems contract in the wake of the recent federal court decision relating to the General Services Board of Contract Appeals' (GSBCA's) jurisdiction. While this court decision changes the effect of the GSBCA ruling, it does not change the findings of the Board that the USPS violated even its own regulations in the Perot Systems procurement.

On August 10, at the hearing before the Senate Governmental Affairs Committee, I stated that the Postal Service and the public interest would best be served by cancelling this contract and starting anew with a competitive procurement. The Postal Service has failed to be persuasive to the contrary. Under the terms of the original contract with Perot Systems, a cancellation now would compensate the company for the few weeks of work performed, and protect USPS from what could be a very costly action if the contract is cancelled at a later date.

If the contract is not terminated, USPS would be perpetuating what the GSBCA termed a "palpably illegal" contract. Congress is currently considering removing USPS from automatic budget constraint law by taking it "off-budget". My and others' support for that concept is based on the premise that USPS will conduct its spending activites responsibly and properly. Failure by USPS to deal forcefully with an illegal contract discredits that premise and creates a feeling of unease among many of us who are strong supporters of the Postal Service.

I hope you will give my comments serious thought in the days ahead. Thank you for your consideration.

Sincerely,

Chuck Grassley

CHARLES E. GRASSLEY
United States Senator

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August 5, 1988

The Honorable Anthony Frank
Postmaster General
United States Postal Service
Washington, D.C. 20260

Dear Mr. Postmaster:

As you know, one of our main goals in the Government Operations Committee has been to assure that the Federal Government attains the best value for the taxpayer's dollar. We believe that our actions over the years have, in fact, made a great difference. The enactment of the Brooks Act, Paperwork Reduction Act, and the Competition in Contracting Act have all contributed toward efficiency and greater competition in Federal contracting.

It is from this perspective that we are writing to express our deep concern over the Service's recent award to Perot Systems, Inc. As long-time proponents of governmental efficiency, we certainly applaud the initiative you have taken in seeking to improve postal ADP operations. Your idea of attaining this goal in the least expensive method is also extremely laudable. However, we believe that these objectives can only be achieved if the Postal Service complies fully with the government's procurement laws and regulations.

Today, the GSA Board of Contract Appeals issued its decision on the protest filed by Electronic Data Systems and Planning Research Corporation on the Perot Systems contract (GSBCA No. 9524-P, 9525-P). The Board ruled that the sole-source procurement was illegal and improper because the Postal Service had failed to follow the Brooks Act (P.L. 89-306). The Board held, therefore, that the contract with Perot Systems was "void ab initio". It has been our longstanding position that the Postal Service was subject to the Brooks Act. We believed from the beginning that the Service was making a grave mistake in not complying with the Act and its requirements to seek competition whenever possible. Now that the Board has ruled in this case, we urge you to quickly implement its decision.

We say this without implying any criticism of Mr. Perot or his company. In fact, we feel the government is fortunate that a man of Mr. Perot's considerable stature and skill is willing to assist the Post Office in solving its ADP problems. However, in the interest of fairness to Mr. Perot's competitors, we believe it is essential that the Post Office open up this contract to full competition under the procedures established by the Brooks Act. These actions will restore the public's confidence in the Post Office and will produce considerable savings through the use of full and open competition. We hope that you agree and look forward to your favorable response to our recommendation.

With best wishes, we are

Sincerely,

JACK BROOKS
Chairman

FRANK HORTON
Ranking Minority Member

THE POSTMASTER GENERAL
Washington, DC 20260-0010

March 8, 1988

MEMORANDUM FOR MIKE COUGHLIN

In anticipation of making money available for the company of last night's guest, could you ask someone to send me a memo on the A. D. Little contract. How much is it, what does it cover, how satisfied are we with it, and is the contract cancelable or transferable -- these are questions that come to mind.

Anthony M. Frank

SENIOR ASSISTANT POSTMASTER GENERAL
Management Information and Research Technology Group
Washington, DC 20260-8000

3-10-88 KGH

MEMORANDUM FOR MR. COUGHLIN

This is in response to your request yesterday regarding the attached memorandum. Attached is a page prepared with Ed Horgan and Jack Davin on the A.D. Little contract. Following it is a brief description from Herb Schiller of some of the A.D. Little work. The expenditures on the A.D. Little contract are down from last year because of the reduction in the FY '88 budget.

Besides exploring the A.D. Little contract options, we also reviewed the availability of funding with Mr. Porras. He advised that the Department of the Controller could develop sources for whatever funding is required. In the simplest case, the revised estimate of the deficit for the year could be adjusted to cover the necessary amount, but other options are available depending on the dollar amount needed. Richard would be happy to review the options with you.

I am scheduled to meet with Postmaster General Frank tomorrow morning regarding the proposed orientation. The orientation has been coordinated with Pete Jacobson who is representing John Mulligan in this regard. We are recommending the initial briefing be in Dallas and include the following:

Bulk Mail Center
Mail Processing Facility
Airmail Facility
Delivery Unit
Retail Operation
Closing Discussion

As agreed, Dave Charters, Pete Jacobson, and myself would attend as well as Howard Buck and Bill Campbell (if Bill is available). Pete feels Dallas is the best location to start at, and it is also convenient to our guest. An outline of the orientation is attached.

Based upon the interest generated from the initial orientation a second tier of briefings on postal technology plans can be arranged to include a Postal Data Center, the Engineering Support Center, the Technology Resource Center, etc. Thank you.

K. J. Hunter

K. J. Hunter

Attachments